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APPENDIX TO THE REPORT OF THE JAPAN-UNITED STATES ECONOMIC RELATIONS GROUP

April 1981

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The Japan-United States Economic Relations Group

APPENDIX

TO THE

REPORT OF THE

JAPAN-UNITED STATES ECONOMIC RELATIONS GROUP

April 1981

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Foreword

The Japan-United States Economic Relations Group, consisting of eight private citizens of the two countries, was established pursuant to a joint communique of May 2, 1979 from the late Prime Minister Ohira and President Carter. The purpose of the Group is to examine factors affecting the bilateral economic relationship over the longer-run and make recommendations to the President and the Prime Minister designed to strengthen it.

The Group's chairmen are Ambassador Nobuhiko Ushiba, former State Minister for External Economic Affairs, and Ambassador Robert S. Ingersoll, former Deputy Secretary of State. Other members are Akio Morita, Chairman, Sony Corporation, Shuzo Muramoto, President, Dai-Ichi Kangyo Bank, Ltd., Kiichi Saeki, Chairman, Nomura Research Institute, A.W. Clausen, President, Bank of America, Hugh T. Patrick, Professor of Economics, Yale University, and Edson W. Spencer, Chairman, Honeywell, Inc. Joint consultations among all members took place in Washington in December, 1979, Tokyo and Oiso in May, 1980, Honolulu in August, and San Francisco in November. The Group was substantially aided by small and effective staffs and a series of commissioned background studies in both countries.

This appendix contains the background studies that the Group drew upon in reaching its conclusions and recommendations. While they do not necessarily represent the views of the Group, the Group found them most useful in preparing its report, and wishes to express its gratitude to the authors.

CYCLICAL AND MACRO-STRUCTURAL ISSUES IN U.S.-JAPANESE ECONOMIC RELATIONS*

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* This appendix is a summary of longer technical reports separately prepared for the U.S.-Japan Economic Relations Group by Eisuke Sakakibara and Gary Saxonhouse. This summary chapter has been prepared by Gary Saxonhouse.

CYCLICAL AND MACRO-STRUCTURAL ISSUES IN U.S.-JAPANESE ECONOMIC RELATIONS*

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    A. The Late 1960s
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* This appendix is a summary of longer technical reports separately prepared for the U.S.-Japan Economic Relations Group by Eisuke Sakakibara and Gary Saxonhouse. This summary chapter has been prepared by Gary Saxonhouse.

I. Introduction

This paper seeks to assess the character of the macroeconomic interdependence between the Japanese and American economies over the past fifteen years. How has this interdependence contributed to the economic instability in both these economies and in these economies' relations with the world economy? Special attention has been given the demand management policies pursued in the U.S. and Japan over this period. What burdens have monetary and other demand management policies in both countries placed on U.S.-Japanese economic interdependence even as other policy goals were being sometimes effectively, and sometimes ineffectively, pursued? Given evolving financial and commercial institutions will the current structure of U.S.-Japanese economic interdependence be maintained throughout the 1980s? To the extent that the present structure persists, what potential is there for successful, coordinated, countercyclical stabilization policies in the U.S. and Japan? What lessons may be culled from the experiences of the last few years? To the extent that financial, commercial and political forces will considerably alter the character of interdependence how may emerging institutions and relationships be shaped to mitigate the problems of the past? To this end, the first half of this paper will review cyclical performances of the Japanese and

American economies. The second half will examine the possibilities for coordination.

II. Past Cyclical and Structural Changes and Interdependence

In the thirteen years since 1967, in only two years, 1974 and 1975, did the Japanese and American balances on current account fail to move in opposite directions. This negative relationship between changes in the flows of Japanese and American current transactions, while varying greatly in size and scope is not accidental. With Japanese data identifying $77 billion in current transactions between Japan and the United States in 1979, there is no larger overseas economic relationship in the world. The opposite and balancing movements in current international transactions of two of the major locii of economic activity in the world are potentially stabilizing influences on the world economy. At the same time these opposite movements can be a source of tremendous friction in bilateral U.S.-Japanese relations. This conflict between bilateral and global needs is most evident when it is recalled that the only two years in the last thirteen in which changes in U.S. and Japanese current international transactions moved together, that is, the so-called "no-problem era" in U.S.-Japanese relations, was in 1974 and 1975, the two worst years for the global economy since the Second World War!

TABLE 1

ANNUAL BALANCES IN U.S. AND JAPANESE CURRENT INTERNATIONAL TRANSACTIONS

($ million)

	Japan		United States	
	Current Balance	Δ In Current Balance	Current Balance	Δ In Current Balance
1967	-190	-	2,584	-
1968	1,048	Δ 1,238	611	- Δ 1,973
1969	2,119	Δ 1,071	399	- Δ 212
1970	1,970	- Δ 149	2,340	Δ 1,941
1971	5,797	Δ 3,827	-1,419	- Δ 3,759
1972	6,624	Δ 827	-5,744	- Δ 4,325
1973	-136	- Δ 6,760	7,141	Δ 12,885
1974	-4,693	- Δ 4,557	4,851	- Δ 2,290
1975	-682	Δ 4,011	18,339	Δ 13,488
1976	3,680	Δ 2,998	4,605	- Δ 13,734
1977	10,918	Δ 7,238	-14,092	- Δ 18,697
1978	16,534	Δ 5,616	-14,300	- Δ 200
1979	-8,754	- Δ 25,288	-800	Δ 13,500
1980	-13,250	- Δ 4,500	+5,000	Δ 5,800

Source: OECD, Main Economic Indicators; Bank of Japan, Balance of Payments Monthly; U.S. Department of Commerce, Survey of Current Business.

A. The Late 1960s

The late 1960s saw for the first time in the post-war period the emergence of a strong Japanese merchandise trade balance which overcame continuing Japanese deficits in invisible transactions and led to a persistent Japanese current account surplus. At the very same time that Japan was having its first sustained exposure to merchandise trade surpluses, the Viet-Nam War strained American economy was experiencing its first merchandise trade deficits in decades. Larger increases in Japanese exports to the United States helped alleviate some of the inflationary pressure created by war-related aggregate demand even as it also created the first post-war bilateral U.S.-Japanese merchandise surpluses for Japan.

The late 1960s also saw the now unusual phenomenon of a major industrialized economy growing at a feverishly rapid pace even as it accumulated larger balance on current account surpluses. Between 1966 and 1972, the Japanese current account improved by almost $7 billion while the Japanese gross national product grew at a secularly unprecedented average annual rate of more than ten percent. Such a coincidence could happen under the Bretton Woods System of fixed exchange rates.[1] An undervalued Japanese yen and an overvalued dollar led to enormous increases in the overseas markets for Japanese goods and fueled export-led rapid expansion and restructuring of the Japanese economy. The disequilibrium in the yen-dollar exchange rate also led to more rapid structural adjustment in American industries than was either desirable or necessary.

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[1] The Japanese and the very similar German experience in the 1960s provided some of the stylized facts for the so-called "monetary" theories of the balance of payments. Such theories stress that economic upswings actually lead to surpluses by demanding accomodating money flows from

The responsibility for coping with the yen-dollar imbalance became a major issue in the early 1970s. Changing the exchange rate was a politically difficult step fraught with significant distributional consequences for both economies. Neither the Japanese nor the American government wished to shoulder the political consequences that initiating such a step might necessitate. Rather, many Japanese stressed that Japanese hard work and thrift and American sloth and self-indulgence and mis-management had created this imbalance and if difficult steps were now necessary it was America's turn for abstinence. In response, many Americans stressed the lack of appropriate formal access to the Japanese market, and the special responsibilities faced by key currency countries under the Bretton Woods System. Because the dollar was international currency, it was argued, the United States must play a passive role in international exchange markets. Changes in

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abroad. This theory is disussed in M. Shirakawa, "Monetary Approach ni yoru kokusai shushi-kawase seito no jisohọ bunsekị--waga kuni no kesu o chushin ni," Kinyu kenkyū shiryō, August 1979.

par-values must be initiated by America's trading partners. It was argued that the problems faced by the dollar were the result of an obvious asymmetry in the potentially self-regulating character of the Bretton Woods System. Persistent deficit in international transactions economies had to change the dollar-denominated external value of their currency. When a persistent deficit sapped an economy of its reserves, a dramatic exchange rate adjustment was necessary. By contrast, surplus economies faced no such natural limit on their ability to maintain an overvalued exchange rate.[2]

In previous episodes of balance of payments surplus, Japanese demand management had allowed domestic inflation rather than exchange rate adjustment to restore external equilibrium. In the context of the late 1960s and early 1970s, the size of the domestic inflation required to remove this surplus was as politically intolerable as exchange rate adjustment itself. Rather Japan sought to deal with a structurally caused external disequilibrium by changing its structure. This strategy relied on a selective liberalization of Japanese trade and capital controls to diminish Japan's surplus. These steps, while having potentially long-term beneficial consequences, proved largely ineffective.

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[2] The issues of this period are discussed in more detail in G. Saxonhouse, "Employment, Import, the Yen and the Dollar," in H. Rosovsky (ed.) Discord in the Pacific (Washington, D.C., 1972).

B. The New Economic Policy of 1971

Initially, it had been the policy of the Nixon Administration to reduce war-engendered inflationary pressures by use of tight fiscal and monetary policy. These policies restored the American current account to surplus in 1970. A slow recovery in 1971, a renewed larger deficit in American current international transactions, persistent outflows of short-term capital, continuing, if reduced, domestic inflationary pressures, and renewed strength in Japan's current account position, together with a perception of ineffective Japanese government countermeasures, however, set the stage for stronger American action.

On August 15, 1971, the American Government finally acted. The Nixon Administration's New Economic Policy (NEP) was designed to simultaneously return the American economy to full utilization of resources even as it restored external equilibrium and smashed inflationary expectations. Japan, among other of America's trading partners was finally forced to allow the yen to appreciate relative to the dollar, American monetary and fiscal turned expansionary, and wage-price controls were instituted.

The NEP had a mixed impact both domestically and on U.S. trading partners. As might be expected, the impact on foreign exchange markets was immediate and the currencies of most of the U.S. trading partners, including Japan's, floated in relationship to the dollar until new paraties were established by the Smithsonian Agreements of December 1971. The American economy, also strengthened in the quarter following the announcement of NEP and stimulated by tax cuts enacted in late 1971 and an expansive monetary policy, commenced on a vigorous expansion which renewed the inflationary expectations of the late 1960s. Only real trade flows proved slow to change in the desired direction in response to the changed environment of NEP. It took almost a year before the American balance on current international transactions began to improve and the Japanese deficit began to decline. In 1972 the Japanese current account surplus and the American current account deficit both reached record levels.

C. The Synchronized Boom of 1972-1973

For whatever reason, the Nixon Administration took the imposition of wage-price controls in 1971 as providing license for pursuing unexpectedly expansionary policies in late 1971 and 1972. In all likelihood, these policies surprised the Japanese and European policy makers. It was expected that American monetary and fiscal policy would help ratify the devaluation by remaining relatively tight.[3] American aggregate demand was expected to shrink in relative terms to make room for greater exports. In consequence, in order to cushion the expected deflationary impact of NEP, Japan and the European economies adopted expansionary policies. What resulted, however, was the simultaneous expansion of the three prime locii of global economy activity.

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[3] R. Komiya and Y. Suzuki, "Inflation in Japan" in L. Krause and W. Salant (eds.) World-wide Inflation: Theory and Recent Experience (Washington, D.C., 1977).

As might have been expected, the global inflationary impact of this great expansion was felt first in the commodity markets. The immediate impact of the dollar devaluation on grains and other American agricultural exports, followed by soaring global aggregate demand, fueled inflationary expectations and led to extraordinary price increases. During 1972 and the first half of 1973 there was a sharp change in the terms of trade between agricultural and non-agricultural products. This change helped finally push the American current account into the black in 1973, even as domestic economic demand was also accelerating. These same changes in relative prices also reinforced a sharp overall decline in the Japanese current account and in the American deficit in merchandise trade with Japan.

The inflationary pressures generated by the massive increases in domestic and foreign demand for American production had by late 1972 and early 1973 made continuance of wage-price controls all but impossible and they were lifted shortly after the start of the Nixon

Administration's second term. This event triggered a massive flight of short-term capital from the United States and ruptured the par-values set by the Smithsonian Agreement. The Bretton Woods International System was finally dead and the managed international floating of currencies which began in February 1973 is still with us.

D. The Oil Crisis

In late 1973, demand in the global economy was straining at capacity. Inflationary pressures in both U.S. and Japan were extreme. In the U.S., a depreciating currency was fueling inflationary pressures while in Japan, the continuing appreciation of the yen was helping to partially alleviate them. From the perspective of most of the world's economies, the OPEC quadrupling of crude oil prices and the Arab oil embargo could not have come at a worse time. With demand straining capacity, the oil embargo effectively removed a portion of capacity in the United States, Japan and other industrialized countries. With inflationary expectations already exaggerated for reasons having nothing to do with oil, this temporary removal of capacity and the subsequent sharp decline in the terms of trade of non-oil producing economies made matters still far worse.

In both Japan and the United States, the immediate aftermath of the oil crisis was an inflationary binge without parallel for the preceding twenty-five years. In Japan, inflationary expectations were accelerated by the sharp depreciation of the yen and ultimately became so severe that widespread panic buying and hoarding ensued. Given the tight labor market and relatively liquid corporate positions which prevailed at the onset of the oil crisis, both Japanese and American employers granted large increases in wages which also magnified inflationary pressures.

E. The Massive Global Economic Recession

While the initial impact of the sharp deterioration in the terms of trade of Japan and the United States and other non-oil exporting economies vis-a-vis OPEC was to heighten inflationary expectations, before long the very size of the financial losses implied by the new price of oil proved highly deflationary. In 1974, in Japan and Europe and to a lesser extent in the United States, current accounts became more negative than before. When the fiscal drag from the foreign sector combined with the almost universal tight fiscal and monetary policies being pursued to brake the enormous buildup in inflationary pressure which antedated the oil prices increases, the result was the most serious global recession of the post-war period. In the United States, GNP growth rates were negative for a full five quarters and in Japan, while growth was sharply negative for only two quarters, the barely positive growth which followed was far away from the average annual increases of ten percent which were so characteristic of the period 1960-1973.

It should be emphasized that it was not simply the foreign and government sectors which were responsible for the recession in Japan and the United States. The household and even the corporate sector in both economies sharply increased their rates of savings out of disposable income, thus diminishing the force of aggregate demand in both economies. This increase in savings was larger and persisted longer in Japan than in the United States. Savings increased cyclically in Japan because the inflation of 1973 and 1974 severely diminished the real value of the large liquid assets Japanese households maintained in saving accounts whose interest rates were fixed and did not respond to changes in inflationary expectations, and because of the grave uncertainties regarding the future of international economic order which the oil crisis had engendered.

F. Unsynchronized Recovery

Once the full scope of the global recession had become entirely clear, and with inflationary pressures subsiding, and the balances of current and capital transactions improving dramatically for both Japan and the United States, both governments began to give a higher priority to steps designed to promote economic recovery. In 1975 both governments adopted relatively expansionary fiscal policies.

In Japan and the United States, personal tax rates were cut to compensate for the increase in the effective real rate of taxation which resulted from inflation pushing households into higher tax brackets than were justified by the increases in their real income. In the United States a liberalized investment tax credit was also instituted. In both countries, there were also significant increases in 1975 in public expenditures.

Both the Japanese and the American recovery helped renew relatively rapid economic growth in 1976, but the international elements of this recovery proved to be dramatically different. For the United States, there was a renewed vigorous increase in the private domestic demand. The rate of household savings out of household income fell from 7.9 percent in 1975 to 5.9 percent in 1976 indicating a healthy increase in consumption expenditures. Complementary with this increase in household expenditure, real private investment increased by 9.5 percent. By contrast, in Japan, household savings remained at a very high 22.5% while investment remained stagnant.

Unlike Japan, which added to capital stock in the early 1970s on the expectation of continuing real rates of growth in GNP of better than ten percent, American visions were much more modest. In consequence, in the period after the oil crisis was over, American corporations, unlike their Japanese counterparts, were not as troubled by the overhang

TABLE 2

PRICES IN JAPAN AND THE UNITED STATES

	Changes in the GNP Deflator		Wholesale Price Index (1970=100)		Consumer Price Index (1970=100)	
	U.S.	Japan	U.S.	Japan	U.S.	Japan
1970	5.4%	6.7%	100.0	100.0	100.0	100.0
1971	5.1	4.7	103.3	99.2	104.3	106.0
1972	4.1	4.7	107.9	100.0	107.7	110.9
1973	5.8	10.9	122.0	115.8	114.4	124.0
1974	9.7	20.1	145.0	152.2	127.0	154.1
1975	9.6	8.6	158.4	156.7	138.6	172.4
1976	5.2	5.6	165.8	164.6	146.6	188.6
1977	6.0	5.6	175.9	167.7	156.1	203.6
1978	7.3	3.9	189.6	163.5	168.0	211.4
1979	8.8	2.0	213.3	175.4	186.9	219.0
1980	9.5	2.0	N.A.	N.A.	N.A.	N.A.

Source: Bank of Japan, Statistics Bureau, Kokusai hikaku tōkei 1980.

of large amounts of under-utilized capacity and heavy debt both of which greatly inhibited new investment. Similarly, the American household, unlike its Japanese counterpart, relatively speaking, did not have large liquid assets and did, nonetheless, have access to a much wider menu of financial instruments by which it could maintain the real value of such assets. In consequence, it required less of an increase over normal saving for the American household to repair its balance sheet after the inflationary shocks of the mid-1970s.

Stagnant domestic demand, and the depreciation of the yen which followed the decline in Japanese terms of trade resulted, in 1976, in a continued dramatic improvement in

TABLE 3

GROWTH RATES IN REAL GNP IN THE UNITED STATES, JAPAN, AND WEST GERMANY

(1967-1979)

	U.S.	Japan	West Germany
1967	2.7%	12.5%	-0.1%
1968	4.4	14.0	6.5
1969	2.6	12.2	7.9
1970	-0.3	11.8	5.9
1971	3.0	5.2	3.3
1972	5.7	9.5	3.6
1973	5.5	10.0	4.9
1974	-1.4	-0.5	0.4
1975	-1.3	1.4	-1.8
1976	5.9	6.5	5.3
1977	5.3	5.4	2.6
1978	4.4	6.0	3.5
1979	2.3	6.0	4.4
1980	-0.7	5.0	1.8

Source: Bank of Japan, Statistics Bureau, _Kokusai hikaku tōkei 1980_.

the Japanese current account. Despite almost completely stagnant private demand, a 22.5 percent overseas demand for Japanese products fed a renewed rapid 6.5 percent increase in the Japanese GNP. By contrast, buoyant American domestic demand and the appreciation of the dollar of the oil producing United States relative to the currencies of its major trading partners, led to a negligible increase in export volume and a huge increase in imports. The very

TABLE 4

GROWTH IN EXPORT AND IMPORT VOLUMES IN JAPAN AND THE UNITED STATES

	United States		Japan	
	Growth in Export Volume	Growth in Import Volume	Growth in Export Volume	Growth in Import Volume
1971	-1.2%	8.6%	19.5%	-3.4%
1972	9.7	13.4	6.9	13.1
1973	23.0	6.2	5.9	28.3
1974	9.0	-3.4	18.0	-5.5
1975	-2.1	-11.2	0.3	-11.5
1976	3.4	21.9	22.0	8.4
1977	0.2	10.3	8.9	2.4
1978	11.9	10.1	1.1	7.0
1979	11.2	10.2	-1.1	10.8

Source: Bank of Japan, Statistics Department, Keizai tōkei geppō U.S. Department of Commerce, Survey of Current Business.

dissimilar structure of the U.S. and Japanese recovery from the global recession led to a re-emergence of a large U.S. merchandise trade deficit with Japan. By July 1976, the "No-Problem Era in U.S.-Japanese Economic Relations" was dead. Its short life lasted a little better than two years.[4]

TABLE 5

U.S.-JAPAN BILATERAL MERCHANDISE TRADE BALANCE

(billions of $)

	U.S. Survey of Current Business Data	Japan Balance of Payments Monthly Data
1970	1.2	1.5
1971	3.2	3.4
1972	4.2	4.0
1973	1.4	1.3
1974	1.6	1.9
1975	1.7	1.0
1976	5.4	5.5
1977	8.0	8.6
1978	11.6	10.7
1979	8.6	7.6
1980	9.9	N.A.

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[4] As early as February 1975 in a paper supplied for the Commission on Critical Choices for Americans, it was suggested that the "No-Problem Era" would have a short life. See G. Saxonhouse and H. Patrick "Japan and U.S.: Bilateral Tensions and Multilateral Issues" in D. Hellman (ed.) China and Japan: A New Balance of Power (Lexington, Mass.: D.C. Health 1976), p. 107.

Despite the strong resurgence of domestic demand in the U.S. in 1976, unemployment remained at better than seven percent of the total labor force and it was generally believed that considerable slack remained in the American economy. What was true for the United States was also assumed to be true for the other major industrialized economies.

TABLE 6

UNEMPLOYMENT RATES IN MAJOR INDUSTRIALIZED ECONOMICS

(% of Labor Force)

	1970	1971	1972	1973	1974	1975	1976	1977	1978
United States	4.9	5.9	5.6	4.9	5.6	8.5	7.7	7.0	6.0
Japan	1.2	1.2	1.4	1.3	1.4	1.9	2.0	2.0	2.2
United Kingdom	2.6	3.4	3.7	2.6	2.6	3.9	5.3	5.7	5.7
West Germany	0.7	0.9	1.1	1.3	2.6	4.7	4.6	4.5	4.4
Italy	3.2	3.2	3.7	3.5	2.9	3.3	3.7	7.2	7.2

Source: Bank of Japan, of Bureau Statistics, Kokusai hikaku tokei 1980.

Unemployment in all the industrialized economies in 1976 was much higher than had been characteristic of the early 1970s and indeed it was higher than had been charateristic for most of the period since 1950. In addition to the continuing persistence of politically unacceptable high unemployment rates, there was also the widespread fear that the deflationary impact of the large OPEC balance of current account surplus with the major market-oriented industrialized economies would trigger another oil-consuming countries' recession. In order to prevent this from happening it was widely suggested that still more expansionary programs were required.[5]

The proposed expansionary programs were to be carefully targeted. While both the declines in gross national product and the subsequent resumption in growth were quite similar there were great differences among the industrialized economies in the rates of domestic inflation being experienced and in the condition of their external accounts. These large differential rates of domestic inflation led to wide fluctuation in exchange rates. In order to promote both economic growth and price stability it was suggested in 1976 that since Germany, Japan and the United States were strong economies with current accounts in surplus or near balance and with relatively low inflation rates, these economies should further expand domestic demand faster than GNP. It was expected that countries such as Canada, France, Italy and the United Kingdom which at that time were experiencing current account deficits and higher inflation rates, would not stimulate domestic demand, but would rather allow their recoveries to be pulled along by an increase in their exports to the so-called "three locomotive economies."

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[5] Paul McCracken et al., Towards Full Employment and Price Stability (Paris: Organization for Economic Cooperation and Development, and 1977) and Organization for Economic Co-operation and Development, Economic Outlook (July 1976 and December 1976).

Unfortunately, this analysis did not entirely comprehend the full extent of the change in the American external position. The American current account had been deteriorating rapidly throughout 1976, so much so that by

TABLE 7

BALANCE ON CURRENT ACCOUNT OF MAJOR WORLD GROUPINGS

($ billion)

	OECD	OPEC	Non-Oil Developing Countries	Other
1970	6.8	-0.5	-8.1	-2.9
1971	9.9	0.3	-9.8	-2.7
1972	7.8	1.3	-5.2	-1.9
1973	9.9	7.7	-6.2	-3.5
1974	-27.5	59.5	-23.3	-9.7
1975	-0.3	27.1	-37.5	-18.5
1976	-19.1	36.6	-25.5	-13.0
1977	-26.3	29.1	-23.0	-8.7
1978	6.4	5.9	-35.0	-10.4
1979	-35.0	68.0	-37.0	-3.0
1980	-73.0	116.0	-50.0	-5.0

Source: Organization of Economic Cooperation and Development.

the latter half of the year the current account was negative. Thus, when the new Carter Administration, taking office with a firm commitment to lower unemployment, embraced the locomotive approach, a major premise for the American role as a locomotive had already dissolved. Of course, this problem became all the more serious when West Germany and Japan did not take up their designated roles as the other two locomotives in the global stabilization plan. In consequence, the American economy sustained an enormous balance on current account deficit, while Japan, its leading overseas trading partner, experienced an unprecedentedly large current trading account surplus.

This Japanese surplus, the result of the interaction of the cautious policies on the part of the Japanese government and Japanese households and businesses with more stimulative actions of the American government put enormous pressure on the Japanese yen. During 1977 the Japanese yen appreciated by 25 percent. Unfortunately, neither this very large yen appreciation nor the special public work programs the Japanese government initiated, nor the attendant, enormous Japanese government deficits had much impact on Japan's external position during 1977 or most of 1978. The Japanese current account surplus increased by another $6 billion in 1978, while the American current account showed no improvement at all.

The large disequilibrium of Japan's external sector during 1977 and 1978 was hardly surprising. During much of the period between 1960 and 1973, the very large savings of the Japanese household sector was absorbed by the almost equally large borrowing of the Japanese corporate sector. After 1973, the Japanese household savings rate increased. By contrast, Japanese corporate investment and therefore, the demand for their available resources, experienced a sharp decline. Because available Japanese household savings were an unprecedentedly large share of GNP, even a Japanese government deficit, which was itself and unprecedentedly large share of GNP proved non-inflationary. Given the very high household savings and the very low corporate investment, a still larger government deficit, probably far in excess of the politically unacceptable 40 percent deficit on central government expenditures, would have been required for external equilibrium to have been achieved in 1978.

While government demand management policies were inadequate during 1977 and 1978, developments in the foreign exchange market also proved slow to have their impact on the Japanese current account. The effective appreciation of the yen by 45 percent during 1977 and 1978 had a relatively quick impact on export and import volumes, but given that these export volumes were now being sold at higher dollar prices abroad and that imports were at the same time cheaper in dollars, it was only at the very end of 1978 that the changes in trade flows were large enough to have their desired impact.

TABLE 8

FINANCIAL BALANCES BY SECTOR IN JAPAN

(as a % of GNP)

Calendar Year	Public Sector	Corporate Business Sector	Personal Sector	Rest of the World Sector
1972	-2.6	-6.8	11.6	-2.2
1973	-2.8	-6.2	8.9	0.2
1974	-3.8	-4.6	7.7	1.0
1975	-7.3	-3.6	10.8	0.1
1976	-7.5	-4.0	11.5	-0.6
1977	-7.2	-2.6	11.1	-1.5
1978	-9.0	-1.0	11.0	-1.7
1979	-7.8	-3.0	9.1	0.9

Source: Bank of Japan, Keizai tōkei geppō (various issues).

F. The Second Oil Crisis

In the last quarter of 1978 and the first quarter of 1979, domestic demand finally recovered sufficiently such that the Japanese current account on international transactions was finally in balance. The rapid growth in consumption expenditures, and particularly in business fixed investment, at this time went hand in hand, even if it was not primarily caused by the externally appreciating yen-induced sharp decline in the Japanese rate of inflation.

In the end it was only a change in the behavior of Japan's private sector induced by higher profit margins, lower inventory and higher capacity utilization rate and by the more stable planning environment brought on by a markedly lower rate of inflation which ended Japan's external disequilibrium. It was only at the end of 1979 that Japanese businesses and households finally emerged from the lingering influence of the first Oil Shock. For example, it was only at this time that Japanese non-residential, non-government real investment recovered to the levels it had reached in 1973.

TABLE 9

JAPANESE GROSS PRIVATE NON-RESIDENTIAL INVESTMENT

(billion yen, 1970 prices) (quarterly data at annual rates)

1969	13,293	1978 1Q	17,393
1970	15,430	1978 2Q	17,768
1971	15,179	1978 3Q	18,082
1972	15,730	1978 4Q	19,690
1973	18,656	1979 1Q	20,760
1974	17,527	1979 2Q	21,064
1975	16,326	1979 3Q	21,419
1976	16,559	1979 4Q	21,795
1977	17,070	1980 1Q	22,109

Source: Economic Planning Agency, *Kokumin shotoku nempo*.

Ironically, at just the time that Japan had fully adjusted to the first Oil Shock, the second Oil Shock occurred. The successful Iranian Revolution in January, 1979, let to renewed tightening of the oil market and a substantial increase in world oil prices. In the fifteen months following the Iranian Revolution world oil prices increased from $13.7 a barrel to some $31.8 a barrel. More recently, spot market prices have reached $42. The impact of the second Oil Shock on the Japanese economy has been remarkably different from that of the first Shock. The second Oil Shock, unlike the first, came at a time when neither Japan nor the global economy was suffering from the burden of excess aggregate demand.

Given the absence of strong inflationary expectations in 1979, the fruit of five years of cautious monetary and fiscal policies, the large increase in the price of oil had a relatively modest impact on the Japanese economy. Unlike 1974, the effective loss of two or three percentage points of GNP due to oil price increases in 1979 and in 1980 did not lead to an immediate dramatic decline in either Japanese investment or in Japanese consumption expenditure. Indeed, the absence of inflationary expectations also made possible, at the same time, relatively modest wage demands by Japan's workers.

The renewed sharp deterioration in Japan's terms of trade which began in 1979, came at just the time when

Japan's dramatic revival in private domestic demand, and the earlier, large appreciation of the yen, the American government's emergency dollar support programs and even the Japanese government's emergency import programs were having a major impact on the Japanese current account. In consequence, during 1979, the Japanese yen depreciated by over 25 percent and there was an unprecedented deterioration in the Japanese current account on international transactions of over $25 billion. This left Japan with a $9 billion deficit. This sharp depreciation of the yen resulted in a renewed growth in Japan's exports. The volume of Japanese exports which had been stagnant since mid-1977 began increasing once again in the second quarter of 1979 and has continued to grow through 1980.

While Japan in 1979 and 1980 has been benefitting from its decision not to pursue an aggressive expansion of its economy in 1977, the United States has at the same time been suffering the consequences of having pursued a rather different strategy. From 1970 through 1977, the U.S. economy had out-performed Japan on managing inflation. The Japanese over-expansion of the economy in 1973 created serious problems for the economic managers in the mid-1970s. Since 1977 relative Japanese and American performance has been quite different. The slack in the Japanese economy helped damp inflationary expectations in Japan after 1976. By contrast, the rapid growth in American

TABLE 10

RECENT PRICE DEVELOPMENTS IN JAPAN AND THE UNITED STATES

	1977	1978	1979	1979 Q. 2	1979 Q .3	1979 Q .4	1980 Q .1	1980 Q .2
Japan Implicit GNP Deflator	5.6	3.9	2.0	3.0	-2.9	3.6	-3.5	3.6
U.S. Implicit GNP Deflator	6.0	7.3	8.9	9.3	8.5	8.3	9.5	10.4
Japan Implicit Private Consumption Deflator	7.2	4.2	3.1	2.0	0.6	1.1	1.5	3.0
U.S. Implicit Private Consumption Deflator	5.7	6.8	8.9	9.2	9.8	9.8	12.4	10.0
Japan Implicit Import Price Deflator	-3.6	-16.2	22.1	10.7	12.6	14.4	11.8	-2.4
U.S. Implicit Import Price Deflator	9.1	5.3	15.4	19.0	35.0	28.0	32.9	8.5

Source: U.S. Department of Commerce, Survey of Current Business; Bank of Japan, Kokusai tōkei geppō.

domestic demand during 1977 and the first half of 1978 rekindled inflationary expectations. The massive deterioration of the current account of the balance of payments and the failure of the other industrial economies to take effective expansion steps led the American government to recognize that it must give new priority to fighting inflation. This new resolve resulted in plans for a tighter fiscal policy, a significant tightening in monetary policy and finally the dollar support, anti-inflationary program of November, 1978.

Unfortunately, before any of these programs could have much lasting impact on inflationary expectations, the second Oil Crisis began. The dramatic increase in oil prices was imposed on an economy with relatively little slack and continuing high inflationary expectations. And unlike Japan, this increase in energy prices quickly spread to intermediate and finished goods and resulted in a substantial acceleration in inflation.

Despite the increasingly tight management of American monetary and fiscal policy, the American economy continued to expand for most of 1979, finishing in more robust health than when the year commenced. Growth in the American economy continued during 1979 because consumption expenditure, fed by a decline in the personal savings rate continued to grow, because high interest rates proved less effective than previously in restraining demand and because of the very strong American export performance.

During 1978-1979, American external sector performance was a mirror image of the Japanese performance. The earlier, substantial depreciation of the dollar finally had its impact on American international trade in goods and services. This exchange rate induced improvement was supported during 1979 by tighter demand management policies which weakened American demand for imports while it freed resources for export.

Despite excellent Japanese and poor American performance on inflation, Japanese trade performance deteriorated during much of late 1978 and through most of 1979, while American trade performance improved. The second Oil Shock, unlike the first, did not impose parallel performance by Japan and the United States. Note also that despite the improvement in the American current account and the deterioration of the Japanese current account during 1979 and 1980, the bilateral merchandise trade deficit the United States had with Japan seems relatively unaffected.

III. Non-Synchronization and the Coordination of Macro-Economic Policy: An Evaluation

A. Linked Econometric Models

Evaluating the effectiveness of demand management policies in Japan and the U.S. and assessing the need for and the possibility of coordinated counter-cyclical stabilization policy presents numerous complex issues. Inevitably both the evaluation of past demand management policies and the consideration of past bilateral conflict are profoundly influenced by both the general analytical framework held appropriate and by that framework's particular empirical implementation.

In a general way, the United States is long past the era when a very small foreign sector, the absence of overseas dependence on critical raw materials and manufactures, and even the lack of an international capital market permitted the framing of macro-economic policy without any regard to foreign consequences or feedbacks.[6]

With growing inter-dependence, an optimal economic policy compels the use of any important policy instrument to be measured against the imperatives of all important policy targets.[7] This, in turn, would imply the coordination of economic policies among nations with a corresponding reduction in national sovereignty. From this perspective, if public housing policy in Japan has an appreciable influence on the price of wheat in the United

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[6] At a theoretical level, this has been appreciated, at least since the classic rendering of the international implications of the Keynesian theory of income deterioration by Machlup, Metzler and Meade in the early 1940s and 1950s; L. Metzler, "Underemployment Equilibrium in International Trade," Econometrica, April, 1942; F. Machlup, International Trade and the National Income Multiplier (Philadelphia, 1943); L. Metzler, "A Multi-Region Theory of Income and Trade," Econometrica, October, 1950; and J. E. Meade, The Balance of Payments (London, 1951). See also R. N. Cooper, "Macro-economic Policy Adjustment in Inter-dependent Economics," Quarterly Journal of Economics, February, 1969.

[7] There are, of course, many examples in the theory of economic policy where such coordination is shown to be unnecessary. Indeed, the early development of this literature by Tinbergen and Mundell suggested that decentralization of policy-making could be effective. Policies should be paired with the objectives on which they have the most influence. See R. Mundell, "The Appropriate Use of Monetary and Fiscal Policy Under Fixed Exchange Rates," IMF Staff Papers (March 1962), and Jan Tinbergen, On The Theory of Economic Policy (Amsterdam, 1952).

States, then the legitimate interest of the United States in the framing of such policy needs to be considered.

Coordination of domestic economic policies in the interest of international economic stability implies a quantitative understanding of the relationships being stabilized. Until the turbulent international economic conditions of the late 1960s and early 1970s, it was not even possible to make a pretense to such quantitative understanding. While working econometric models of national economies had been available since the early 1950s, in all these models the world beyond the domestic economy was treated as a non-interactive part of the environment. These models could not assess the specific consequences for one country of a policy initiated in some other country. Empirical internal consistency could not be meshed with empirical consistency.

More recently a large number of internationally linked econometric systems purporting to capture most, if not all of the major means by which economic disturbances are transmitted from one country to another have been developed. The possibility of an empirically based internationally coordinated macro-economic policy would appear to be tantalizingly close.[8]

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[8] These systems include among others, Project Link initiated by the Wharton School, the Mini-Meteor Model by the Centraal Plan Bureau in the Netherlands, the Multilateral Exchange Rate Model by the International Monetary Fund, the Multi-Country Model by the Federal Reserve System

For example, with the software available from this econometric work, it is possible to examine what might have happened to the major industrialized countries and other actors in the global economy had the three locomotive coordinated fiscal and monetary policy been fully adopted.

Most of the extensive simulation work which has been done with linked world econometric models does suggest that at least some of the problems which the American and the world economy faced in the late 1970s might have been alleviated had a synchronized, coordinated fiscal and monetary policy been pursued by the American, Japanese and German economies. Such simulation work suggests that further expansion and possibly greater stability for the world economy could have been achieved during the period

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in the U.S., the E.P.A. World Economic Model by Japan's Economic Planning Agency, the OER Linked Policy Impact Model by the Central Intelligence Agency's Office of Economic Research and the OECD's InterLink Model. These models are described in K. N. Johnson and L. R. Klein's "Stability in the International Economy: The LINK Experience" in A. Ando et al. (eds.) International Aspects of Stabilization Policies (Boston, MA, 1974). Centraal Plan Bureau, Mini-Meteor: A Simple Multi-Country Simulation Model (The Hague, 1974). Howard Howe et al., "Assessing International Interdependence with a Multi-Country Model," International Finance Discussion Paper No. 138. Economic Planning Agency, Trade Linkage Sub-Model in the EPA World Economic Model (Tokyo, 1980) and M. C. Depple and D. M. Repley, "The World Trade Model: Merchandise Trade," IMF Staff Papers, March, 1978, and OECD, "The OECD International Linkage Model," OECD Occasional Studies January, 1979. Significantly, the OECD InterLink Model is used as a regular part of the OECD semi-annual forecasting cycle for checking international consistency. Of course it was the OECD which was a major proponent of the locomotive policy.

following 1976 at the possible cost of additional inflation for Germany and Japan. According to this econometric work, had the locomotive been run as planned, they would have had the strength to exert real pull on other economies.[9]

B. The Empirical Underpinnings of Coordination

Whether simulation work actually vindicates the locomotive approach and provides the basis for future coordination of macro-economic policy remains a complex issue that needs to be discussed from a variety of perspectives. For example, how much information is there in the large-scale econometric models which are the intellectual underpinnings of an internationally-coordinated macro-economic policy? For all their complexity, such models, by and large, do not provide relatively accurate forecasts and simulations.[10] While it is always possible to rationalize poor forecasts on the grounds of lack of accurate information on policy variables, large-scale econometric models have been subjected to more fundamental criticism.[11]

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[9] In the absence of linked econometric evaluation the pulling power of the impact locomotives might seem quite small. For example, it was recommended that West Germany, as a locomotive, should stimulate its economy by 1% of GNP. Roughly speaking, West Germany's GNP elasticity of imports is 2. Assuming that import shares remain constant, German stimulation would result in the additional demand for United Kingdom GNP of 0.05%, the additional demand for French GNP of 0.07% and the additional demand for Italian GNP of 0.06%. This arithmetic calculation which is made by Wood and Jianakopolos in "Coordinated International Economic Expansion: Are Convoys or Locomotives the Answer?" Federal Reserve Bank of St. Louis Review, July, 1978, and may be contrasted with findings from the simulations conducted with the OECD InterLink Model. Such simulation indicates an increase in demand for French GNP of 0.4%, an increase in demand for the United Kingdom's GNP of 0.34% and finally an increase in the demand for Italian GNP of 0.46%.

[10] J. Armstrong, "Forecasting with Econometric Methods: Folklore versus Fact," Journal of Business, October, 1978; C. Nelson, "Rational Expectations and the

Much of these discussions finally boil down to whether the global economy is viewed as primarily deterministic or primarily stochastic. A deterministic system suggests

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Predictive Efficiency of Econometric Models," *Journal of Business*, July, 1975; Y. Oritani, "Money Supply oyobi zaisei shishutsu to meimoku GNP no kankei ni tsuite," *Kinyū kenkyū shiryō*, January, 1979; M. Shirakawa, "Monetary Approach ni yoru kikusai shushi kawase seito no jisoho bunseki--waga kuni no kesu o chushin ni," *Kinyū kenkyū shiryō*, August, 1979; M. Shirakawa, "Gaikoku kawase shiryo ni okeru kitai keisei ni tsuite," *Kinyū kenkyū shiryō*, August, 1979; Y. Oritani, "Infure kitai to kinri--Fisher kika kensho to sono implication," *Kinyū kenkyū shiryō*, September, 1979; and Y. Oritani, "Application of Akaike's Method to Economic Time Series," *Kinyū kenkyū shiryō*, September, 1979.

[11] For example, it is argued that most large-scale econometric models are not statistically identified. Such models are typically specified one equation or one bloc at a time with the result that the zero identifying restrictions appearing in any given model are artificially imposed. Full systemic treatment of such restrictions would make many of them appear most unreasonable. Furthermore, the necessary dynamics of such models presume a prior knowledge of exact lag length and orders of serial correlation. Finally, even on their own terms many such models fail identification because of model-builders' typically arbitrary distinction between endogenous and policy variables. Criticisms in this spirit have been made in R. E. Lucas "Econometric Testing of the Natural Rate Hypothesis" in Board of Governors of the Federal Reserve System. *The Econometrics of Price Determination* (Washington, D.C., 1972); R. E. Lucas, "Macro-Economic Policy Evaluation; A Critique" in K. Brunner and A. Meltzer (eds.), *The Phillips Curve and Labor Markets* (Amsterdam, 1976). C. Sims, "Macro-economics and Reality" *Econometrica*, January, 1980 and Z. Griliches, "The Brookings Model; A Review Article," *Review of Economics and Statistics*, May, 1968.

policy makers know most relevant details of economic structure and therefore have the opportunity to successfully control the system. Most discussions of fine tuning or international coordination of demand management policies are carried out under this prescription. Increasing numbers of economists and mathematical statisticians are beginning to question whether the state of knowledge in economics warrants the use of such deterministic models. There are so many aspects of the economic system which are not presently known or cannot be pinned down in sensible causal relationships. Under this view, the economic system is largely stochastic. As early as the 1930s, the Nobel Prize winning economist, Ragnar Frisch hypothesized that it is these unknown disturbances which generate economic cycles. By definition, these unknown disturbances cannot be predicted unless future disturbances are in some way related to present and past disturbances.

If these disturbances are correlated in some regular fashion, predictions can be generated and to that degree the economic system can be manipulated. The degree of accuracy of forecast or feasibility for control, however, depends upon the degree of correlation of these disturbances. Research conducted for the Japan-U.S. Economic Relations Group suggests that extent of control for the yen-dollar exchange rate, the U.S. and Japanese trade balances and Japanese and U.S. production is relatively limited.[12] In other words, the movement of the exchange rate, the trade balance and Japanese and U.S. production are largely dominated by relatively difficult to predict disturbances and attempts to control them within a reasonable margin of error run a high risk of failure. Simulations conducted in the course of this research indicate that although the complete coordination of monetary policy and/or complete synchronization of cycles does damp fluctuations in the exchange rates and trade balances somewhat, substantial swings in these variables are inevitable as long as the current free regime of international transactions is maintained.

C. The Perverse Consequences of Synchronization

It is not simply that the coordination of international macro-economic policy is likely to be ineffective. Rather there is the danger that attempts at such coordination might have perverse results. If coordination is understood to be movement in tandem of the Japanese, American and possibly the West German economies in order to mitigate trade imbalances and exchange rate fluctuations, such coordination might run the risk of destabilizing the rest of the world economy. A stable world economy rests on the absence of parallel movements in the major elements of the world economy. Notwithstanding the increasing interdependence of national economies, the natural transmission mechanism of economic shocks from one country to another will quickly damp large disturbances emanating from any one country. By contrast, a growing replacement of internationally decentralized demand management by synchronized policies might work to enhance such shocks.[13]

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[12] E. Sakakibara, "Structure of U.S.-Japanese Economic Interdependence and Feasibility for Policy Coordination."

It is a matter of debate whether suggesting parallel movements in the American, Japanese and West German economies might further synchronize or non-synchronize the global economy. If the deflationary impact of a large increase in the nominal value of OPEC exports is met by an expansion of American, Japanese and German domestic demand, then from a global perspective which includes OPEC, three locomotives running down the track might be thought of as globally stabilizing behavior. Of course, this was the perspective from which the locomotive policy was framed in 1976. As has been discussed earlier, this perspective did not fully incorporate the strength of underlying expectations still present in the major industrialized economies. The OPEC price increase, like all such large price increases, has had a three pronged impact. At one level, such increases are deflationary because they reduce real income and hence demand. At another level, such large increases, by rendering a portion of production capacity economically obsolete, reduce supply as well as demand.[14] Finally, and only loosely related to its other supply and demand effects, OPEC price increases can significantly alter expectations regarding the underlying rate of price inflation. In the context of the original debate regarding the appropriateness of a locomotive approach to global stabilization in 1976-1977, the character of expectations regarding the underlying rate of inflation, and how the unknown but possible inadequacy of effective supply might affect such expectations, could only be dimly understood.

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[13] B. Hickman and S. Schleicher, "The Interdependence of National Economics and the Synchronization of Economic Fluctuations: Evidence from the LINK Project," Weltwirtschaftliches Archiv, 1978.4.

The unpredictable and possibly uncontrollable character of the world economic system seems to stem in some measure from the effects from, and the erratic nature of, expectations held by economic decision makers whether in the household, the corporation or government. The influence of such expectations have been particularly conspicuous in foreign exchange markets. Expectations had been relatively stable in the 1950s and 1960s when the world trade and financial system was more solidly anchored. As the Bretton Woods System began to exhibit weaknesses in the late 1960s and early 1970s, the changing expectations of private transactors began to play a more central role. Such expectations became crucial in the determination of exchange rates, but also played a more and more important role in trade and production decisions as well.

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[14] R. Raasche and T. Tatum, "The Effects of the New Energy Regime on Economic Capacity, Productions and Prices," Federal Reserve Bank of St. Louis Review, May, 1977 and J. R. Artus, "Measure and Potential Output in Manufacturing for Eight Industrialized Countries, 1955-1977," IMF Staff Papers, March, 1978.

Private transactors closely watch the moves of policy authorities and form their expectations on the basis of their expected moves and other information available to them. To this extent, both fiscal and monetary policies can have profound effects on the economy. It may be difficult, however, to assess the impact of these policies because it is possible they operate mainly through expectations and not through the traditional channels specified by demand-oriented econometric models. There are not yet analytical frameworks which adequately capture the generation and aggregate economic role of such expectations.[15] Substantively, all that can be done at this stage is to make some conjectures about the effects of policies on expectations and to draw some qualitative implications. The poor predictive performance of large scale econometric models stems at least partially from its failure to incorporate expectations in an appropriate manner.

While expectational elements may make the global economic system relatively unpredictable and uncontrollable, this is not necessarily the same as implying that policies are unimportant. On the contrary, as the previous analysis indicates, they may have been quite instrumental in generating the current acceleration in world inflation. Expansionary monetary and fiscal policies in the United States during the 1976-1979 period may have generated expectations of permanent price inflation, which have been difficult to counteract by the subsequent tightening of policies. The experience of the United Kingdom and Italy subsequent to the expansionary monetary and fiscal policies they employed during 1974 and 1975 are also pertinent in this regard. By contrast, the cautious policies of Japan and Germany, immediately following the first oil crisis, while delaying recovery, did successfully damp inflationary expectations and seem to have laid the groundwork for subsequent solid economic growth. Ever since the first Oil Shock, inflation has become a major concern for all economic decision makers and expectations regarding inflation have become a prime determinant of the character of the economic system. Policies not placing a major emphasis on this aspect of the system seem ultimately ineffective in one way or another. Traditional concern for unemployment remains most important but unless policies succeed in damping price expectations, they do not appear to be effective in reducing unemployment.

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[15] B. Kantor, "Rational Expectations and Economic Thought," Journal of Economic Literature, December, 1979.

Synchronization of fiscal and monetary policies among the major industrialized economies surely runs the risk of frustrating this objective.

D. Economic Diplomacy for Decentralized Economies

Even if the enhancing of the international business cycle were not a consideration, there are other reasons why even the very process of coordination, let alone synchronization might turn out to be destabilizing. In the absence of a commonly shared view of economic reality or even with a commonly shared view, but in the absence of commonly shared tastes for inflation, unemployment, exchange rate movements and trade balances, international macro-economic policy coordination can quickly become the subject of high level, and possibly high profile diplomatic initiatives. At its best, institutionalizing regular international consultations on macro-economic policy can prevent miscalculations of the sort which occurred in late 1971 and 1972 when Tokyo apparently did not appreciate the extent to which Washington was pursuing expansionary policies. Most likely, however, given the continuing asymmetries in economic diplomatic leverage, coordination can quickly lead to American pressure on Japan to change its macro-economic policies. From the Council on the International Economic Policy through the more recent Economic Summitry there is ample evidence that this is an habitual outcome.

There is nothing illegitimate about resolving policy differences among nations facing common problems with a measure of pressure. At the same time, it is necessary to understand that the international diplomacy of macro-economic policy is different from both the diplomacy of international security policy and even the diplomacy of international commercial policy. Governments do not command economies. London and Bonn Summiteers and Messrs. Strauss and Ushiba can agree to a target rate of growth of GNP or target current account surpluses, but the ability of the governments represented by Summiteers and Strauss and Ushiba to accomplish such objectives is relatively limited. As has been observed, this powerlessness may spring from the limits of economic theory and quantitative understanding. It may also spring from the very character of what the great non-Communist industrialized economies remain today. Aggregate economic performance rests on the decentralized decision-making of countless corporations, households and even government entities. In non-hierarchical economies agreement among international elites on targets and even instruments is not enough.

If, as has been previously discussed, policy works its influence through altering economic decisionmakers' expectations rather than through more traditional direct channels, then the character of diplomacy as well as the substance of policy needs careful re-evaluation. An unstable policy environment can have important impact on aggregate economic behavior through its influence on household and business decision-making.[16] Macro-economic policies which are exclusively informational and which do not presume further negotiation for achieving more concrete coordination doubtless enhance economic stability. Consultation which presumes a coordinated strategy towards achieving global macro-economic objectives may have the opposite impact. Public wrangling between the United States and Japan over macro-economic instruments and targets can also have perverse effects. For example, uncertainty generated by such a diplomacy aimed at fiscal and monetary expansion in Japan, either through its impact on the exchange rate or directly, will undermine spending plans of households and corporations.[17]

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[16] B. Kantor, "Rational Expectations and Economic Thought."

[17] G. Saxonhouse, "Helping the Japanese Economy," New York Times, January 11, 1978.

IV. LAGS IN ADJUSTMENT AND OVERSHOOTING

Despite the almost continuous effective appreciation of the yen from 1976 through 1978 it was only during the first quarter of 1979 that the Japanese current account finally went into deficit and indeed it was only with the last quarter of 1978 that the large Japanese surplus showed definite signs of diminishing at all. During the better

TABLE 11

THE JAPANESE BALANCE OF PAYMENTS
(U.S. $ Million, seasonally adjusted)

	EXPORTS	IMPORTS	SERVICES AND TRANSFERS (NET)	CURRENT BALANCE
1976	66026	56139	-6207	3680
1977	79333	62022	-6393	10918
1978	95634	71038	-8062	16534
1979	101232	99387	-10599	-8754
1978Q3	24263	17563	-2205	4495
1978Q4	24887	20669	-2120	2098
1979Q1	24221	21725	-2401	95
1979Q2	24691	22774	-2649	-732
1979Q3	25804	24807	-2874	-3877
1980Q4	26474	28087	-2675	-4288
1980Q1	28035	29926	-3277	-5168
1980Q2	30997	32365	-3258	-4626

Source: Bank of Japan, Kokusai shushi tokei geppō.

than two and one-half years that the rest of the world waited for Japan's surplus to diminish, doubt was periodically expressed as to whether in Japan's case the international adjustment mechanism was working properly. Doubt was expressed as to whether appreciation of the yen was actually reflected in the foreign currency price of Japan's export or, for that matter, in the yen price of Japan's imports. And even if such price change did occur there was doubt, on the one hand, because of the high quality of many Japanese exports and on the other because of the alleged lack of market access for imports to Japan, that trade flows would respond in a significant way to such price changes. Such doubt was expressed in concrete ways. In the first instance, speculators drove the yen as high as ¥ 176 in late 1978. Second, as late as the first quarter of 1979, Washington was urging Tokyo to take dramatic new steps to reduce its unacceptably large global current account surplus.

In fact, there is a massive amount of empirical work on the Japanese foreign sector and the character of the international adjustment mechanism. With perhaps a number of minor exceptions all this work suggests that a change in the price of the yen relative to other currencies will result in a substantial change in the Japanese current account balance. All the major econometric models of the Japanese economy come to this conclusion regardless of the detail or the lack of detail in their treatment of the foreign sector and its linkages with the domestic economy and abroad.[18]

Similarly, virtually all work on the price sensitivity of Japan's export demand, which is one of the building blocks of any conclusion with respect to current account balance also finds price changes efficacious. This empirical work on export demand has been carried out at varying levels of disaggregation. Japan's export demand has been disaggregated with respect to markets and separately with respect to different goods.[19] There has also been disaggregation in some of the same models between goods and different services. None of this disaggregation changes the optimistic qualitative conclusion of the more aggregate work.

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[18] For example, A. Amano, K. Ban, and C. Moriguchi, A Quarterly Forecasting Model of Japan, Kyoto Institute of Economic Research, Kyoto University Discussion Paper No. 81, 1975 and Short-Term Econometric Model SP-18, Economic Research Institute, Economic Planning Agency.

[19] One of the more comprehensive elaborations of foreign markets for exports takes place in the Kyoto University Model. There are separate equations for (1) the United States and Canadian Markets, (2) the EEC/EFTA, (3) Oceania and South Africa, (4) Southeast Asia and (5) other non-socialist economies. See A. Amano, An Econometric Model of the Japanese Balance of Payments, 1961-1970 (Kobi, Japan; Kobi University, 1975) and A. Amano, K. Ban, and C. Moriguchi, "A Quarterly Forecasting Econometric Model of Japan."

On the import side, empirical work has produced rather more diverse results. It is not uncommon for aggregate equations representing Japan's imports of goods and services not to contain any price variable at all.[20] The level of imports in such work depends solely on one or another activity variable. This means that with an appreciation of the yen such import equations would forecast a decline not an increase in the dollar value of imports.

Such results at the aggregate level are not surprising given the commodity structure of Japanese imports. While the commodities in the Standard International Trade Classification (SITC) Groups 0-4 are highly price elastic with respect to a particular foreign source, they are almost always price inelastic, if not entirely price insensitive, with respect to all foreign sources.

Where there are more diverse results are in the manufactured goods SITC Categories 5-9. Given that at least some of these producers are thought to be in competition with domestic suppliers, it is expected that some price sensitive behavior might be uncovered. And this is typically, but not always the case with econometric work on these commodity groups.[21]

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[20] See, for example, the import equation in the Japan Economic Research Center's Medium Term Econometric Model I.

If the basic qualitative result is not in doubt for Japan, what does seem in question is the timing and size of the impact. Recent work, in part sponsored by the Japan - United States Economic Relations Group, does suggest, however, that the pass-through of exchange rate changes to foreign currency export prices does occur relatively rapidly with most of the pass-through being accomplished within the first six months of the exchange rate change. What may be still more surprising is rapid response of Japanese export volumes to relative price changes. Perhaps half the Japanese response to such changes occurs within the first year or so. There is reason to believe that such response is considerably faster than that of most other advanced industrialized countries.

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[21] In the Kyoto University Model among eight commodity import equations only two, machinery and textile raw materials, have statistically significant price materials. More recent work by the OECD suggests that aggregate Japanese manufactured imports are extremely price sensitive. Earlier work summarized by G. K. Taplin in "A Model of World Trade" and G. Basevi, "Commodity Trade Equations in Project LINK"

As might be expected from the previous discussion, what can be said about imports is still ambiguous. Among all imports, relative prices matter, at best, only for manufactured goods. Evidence presently available remains mixed as to the speed of the pass-through of exchange rate changes to yen prices of such imports. Once the price change does occur, the volume response for imports is about as quick as for exports. Successful competition on the basis of price with domestic producers of import substitutes does seem to be occurring in the Japanese market. Sharp swings in relative prices owing to wide fluctuations in the Japanese effective exchange rate have resulted in considerable fluctation in the volume of Japanese-imported manufactures.

If there is a relatively quick response of Japanese trade volumes to price changes and if price changes, at least on the export side, respond relatively quickly to exchange rate changes, how is the persistence of the Japanese

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in R. J. Bell (ed.), The International Linkage of National Economic Models (Amsterdam, 1973), also suggest that Japan's imports in SITC Categories 5-9 are generally price elastic and roughly the same order of magnitude as other advanced industrialized countries.

current account surplus during 1976-1978 and indeed in 1971-1973.1 to be explained. In the first place, it should be understood that it is easy enough to discuss the first order impact of an exchange rate adjustment on exports and imports and on the current account. Where there is less evidence concerns the second-order impact from the domestic economy, which has been affected by the exchange rate adjustment, upon the current account. *A priori*, such second-order effects are thought to have relatively little impact in exports, but given the importance of domestic activity variables on imports, the effect here could be most substantial. The deflationary impact of an exchange rate appreciation in the absence of compensating fiscal and monetary policies can undercut the price effects of such appreciation. During 1976-1978 many Japanese economists agreed that the Government was relying far too exclusively on exchange rate policy to manage its external disequilibrium.[22]

Even if half the volume response of Japanese trade flows to exchange rate changes occurs within a year and even if Japanese exports and the manufactured goods portion of Japanese imports are highly and relatively price sensitive it is still possible for exchange rate changes to have persistent perverse consequences and this will be especially so if aggregate demand management does not or cannot work to support the intended exchange rate consequences. This will happen if there is a continuous appreciation of the yen over an extended period of time. As volumes adjust to price increases, the perverse consequences of the initial exchange rate adjustment are removed, but continuing appreciation of the yen during the period between the initial price increase and the subsequent stabilizing volume adjustment will mask this improvement. If speculators are impatient, the lags in adjustment can make for a highly unstable system. Clearly such processes have caused overshorting of the yen and delayed the full Japanese current account adjustment in both the early and late 1970's.[23]

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[22] This argument was made by C. Moriguchi in the "Keizai kyoshitsu" section of July 25, 1977 edition of the *Nikon keizai shimbun*.

V. CURRENT CYCLICAL OUTLOOK IN JAPAN AND THE UNITED STATES

During 1979 and much of 1980, Japan continued to reap the stabilizing benefits of the previous long period of yen appreciation. An appreciating yen cut the rate of domestic price inflation, which in turn greatly moderated the wage demands of the Japanese labor force. The decline in the rate of domestic price inflation, in turn, led to increased household expenditure and corporate investment.[24]

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[23] This is discussed in more detail in Economic Planning Agency, Nenji keizai hōkoku (Tokyo, 1979).

More recently the yen depreciation of 1979 has begun to have a more general impact on the Japanese economy, even as once again the yen begins to appreciate. The rate of consumer price increase after decelerating for three years, while still remaining well below the U.S. rate, did double during the past year. Closely related to this, domestic demand has begun to falter. After rapid real increases in 1979, both household spending and corporate investment have recently been growing very slowly. With household savings increasing once again, not unlike the period prior to 1979, the growth of the Japanese is being maintained by increased exports and government expenditure. Because of the very large increase in the Japanese oil import bill, despite substantial increases in net exports during the latter part of 1979 and through 1980, the Japanese current account remains in deficit. Also, notwithstanding the continuing current account deficit and uncertainties about the future price of oil, Japan's capital account has shown considerable improvement. Foreign investors are putting significant long-term and short-term resources into yen assets.

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[24] E. Sakakibara, Zaisei kinzoku seisaku no hyoku to Phillips' Curve (Tokyo, 1980).

The present American economic experience continues to contrast sharply with that of Japan, though perhaps not so sharply as a year ago. The acceleration of inflation last year worked through the progressive personal income tax to create substantial fiscal drag with American economy. This fiscal drag together with an activist tight money policy helped finally kill off the long American recovery from the first oil crisis even as it dramatically improved the U.S. current account.

With inflationary expectations still high even in the presence of very substantial excess capacity, the American economy is now paying the price for its rapid expansion during the mid-1970's. Because of institutional changes to curb disintermediation, the tightening of monetary policy no longer works in the real sector by primarily drying up resources available for residential construction. Now monetary policy has more of a diffuse impact. Far higher rates are necessary to achieve the same restrictive impact. Policies which once worked by contracting the geographically diverse residential housing industry now have a much more direct impact on the demand for the products of the geographically more concentrated consumer durables industry. Unhappily, as in automobiles, these American industries, while they are facing new cyclical pressures, also face permanent structural problems from a growing Japanese competitive strength driven by a continuing need to pay for ever more expensive imported oil.

ENERGY AND U.S. - JAPAN RELATIONS

by

Joseph S. Nye
Harvard University

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I. The Role of Energy: Four Dimensions

Energy will play a critical role in the Japan-U.S. relationship over the next decade, reflecting its central role in each of the two societies. If it is poorly handled, the energy issue could pose a major threat to the relationship. Properly handled, the energy issues presents a significant cooperative opportunity to deepen the relationship.

The United States and Japan are the first and second largest consumers of free world energy. They are also the two largest importers of oil representing half (30 percent and 20 percent) of the approximately 26.5 million barrels of oil which the OECD imports each day Given their size in energy markets, the two countries are highly interdependent on energy issues. The actions of one cannot avoid affecting the other. This energy interdependence has four major dimensions: price, security of supply, foreign policy, and energy policy.

1. Price. Both economies are highly sensitive to even marginal changes in the world oil market as events in 1979 demonstrated. According to the International Energy Agency (I.E.A.) the two month stoppage of Iranian production at the beginning of the year never created more than a 4 percent overall shortfall, and amounted to only an average of one percent shortfall over the first six months of the year.[1] Nonetheless, these pertubations led to more than a doubling of prices (123 percent) over the course of the year.

Sensitivity to oil markets led to some responses which reduced friction in the U.S.-Japan relationship and to others which increased friction during the last year. The April 1979 U.S. decision to begin decontrol of prices and the Tokyo Summit agreement to set an upper limit on oil imports helped to reduce the irritation that had arisen over the 25 percent rise in U.S. oil imports between 1974 and 1978. Nonetheless, some Japanese felt the U.S. ceiling was too high because it reflectd that lax performance. On the other side, new frictions arose over the role of Japanese companies in bidding up oil prices under the tight market conditions of 1979. The most dramatic instance of this new friction was Secretary Vance's December 1979 public criticism of Japanese oil purchases from Iran.

2. Security of Supply. While price under normal conditions is obviously an important dimension of energy interdependence, it is dwarfed by the problem of security of supply. For example, a U.S. Department of Energy study estimates that the costs of a potential supply interruption (in the absence of countervailing measures) could range from 84 to 323 to 686 billion dollars for the annual loss of 3, 10, or 20 million barrels per day (mbd).[2] These numbers correspond roughly to the annual loss of production from respectively, Iraq, Saudi Arabia, or the entire Persian Gulf. In short, with 40 percent of its oil consumption provided by the Persian Gulf, the free world economy is highly vulnerable to political events in one of the world's less stable areas.

If this vulnerability is threatening to the United States, it is even worse for Japan which is four times more dependent on energy imports (88 percent compared to 22 percent); more dependent on oil (75 percent of total energy compared to 50 percent); and more dependent on Persian Gulf sources (78 percent of oil imports compared to 30 percent).[3]

3. Foreign Policy. Japanese efforts to diminish vulnerability to interruptions by altering foreign policy positions; and U.S. efforts to prevent such trade-offs pose a potentially dangerous source of friction in the relationship. One could imagine tensions arising over the Middle East peace process; relations with China or the Soviet Union; nuclear non-proliferation policies; management of the world economy; alliance burden sharing, and so forth. In addition, foreign policy problems will arise out of price considerations, either directly as already mentioned, or indirectly through the effects of high prices on stability of fragile economies in poor countries recycling of petrodollars; and international trade.

One of the lurking dangers in foreign policy is that Japan will fail to reach its targets for alternative energy supply (see Section III), and will be forced to purchase more oil on world markets than allowed for in the ceiling it agreed to at the Tokyo Summit. Not only would this cause political acrimony, but paying for the oil would require additional exports that could exacerbate protectionist reactions. Political acrimony could also result from U.S. failure to meet its oil import targets. In short, major foreign policy problems may arise if energy problems are poorly handled and spill over into other aspects of the relationship.

4. Energy Policy. Given their size in the oil market, the U.S. and Japan cannot escape interdependence in their energy policies. Steps that each country takes to deal with its energy problem can weaken or reinforc the position of the other. For example, the price effects of demand restraint by one of the two countries would be nullified if the other failed to restrain demand. Equally important are the opportunities for cooperative actions in regard to two key measures that could reduce the costs of supply interruptions

stockpiles and a disruption tariff. If stockpile purchases and releases are coordinated, the undesirable effect of raising prices during acquisition can be reduced and the desired effect of lowering prices during a crisis can be enhanced. Similarly, if both countries imposed a tariff or tax on oil imports when a shortage occurs, the economic costs of the interruption would be reduced. Price would rise in any case, but the transfer of wealth to OPEC could be reduced. By one estimate, a loss of 9 mbd in 1990 that would cost the U.S. 6.5 percent and Japan 9 percent of GNP, would instead cost 3.5 percent and 2 percent respectively if a disruption tariff were applied.[4] However, since one country can benefit from the world price-depressing effects of the other's tariff without imposing such costs on itself, the resulting acrimony in the relationship could be great.

In short, although there are important differences of degree, the U.S. and Japan are both sensitive to oil price changes and vulnerable to supply disruptions. Their policies to deal with this sensitivity can largely nullify or enhance each other in the oil area, and can threaten or enrich their larger relationship over the next decades.

II. The Changing International Energy Situation

A. Projections

Energy projections have been notoriously unreliable. According to Koreisha and Stobaugh's review of energy models, "the major studies since 1973 have given us predictions about the U.S. energy situation that have been consistently more optimistic than the reality has proved to be, especially in regard to energy supplies."[5] On the other hand, projections of energy demand have been consistently too high and drifted downward over the decade. For example, in 1972 the U.S. Atomic Energy Commission projected U.S. end of century demand at 160 quads (quadrillion BTUs). By 1976, its successor agency lowered this projection to 124. Almost all studies failed to anticipa lower growth, higher oil prices, and reduced energy to GNP ratios.[6]

Similar trends are found in company demand projections. In 1973 Exxon projected 1985 Free World demand at the equivalent of 163 mbd of oil; by 1977 this was lowerd to 130 and last year it was further reduced to 118.[7]

One reason for difficulty in projection and for the downward trend in demand forecasts has been slackening GNP growth rates. Another reason is uncertainty about how responsive demand will be to changes in price. Given the unprecedented levels to which prices have recently risen, historical data about the price elasticity of demand at lower prices may be quite misleading as an indicator of the future. Over the decade, ratios of energy to GNP have tended to decline among OECD countries, but they also oscillate widely. The Summit leaders at Venice set a target of .6 in energy to GNP ratios by 1990, indicated that growth could increase without proportionate energy demand increases. Nonetheless, the Summit statement is a target not a prediction.

The supply side is even harder to project because it depends more heavily on political factors than does demand. For example, political and environmental factors have tended to undercut projections of nuclear and coal supply. The largest supply factor will continue to be oil; particularly the rate of OPEC production which represents about half of the Free World consumption. In the early 1970s, it was common to find bouyant projections of OPEC production in the range of 40 to 60 mbd in the 1980s. The original Saudi Arabian development plan called for raising production to a level of 20 mbd. By 1977, the CIA and the private Workshop on Alternative Energy Strategies were projecting OPEC supply would fail to satisfy demand by the early to mid-80s.

A 1979 comparison of eight major government, international organization, and private company forecasts made between 1977 and 79 found most of their estimates for OPEC production fell between 30-35 mbd for 1980; 33-39 mbd for 1985 and 36-46 mbd for 1990.[8] As recently as May 1979, the IEA forecast OPEC production at 38 mbd or higher in 1990; in 1980 this figure was reduced to 30 mbd.

The current conventional widsom is that oil markets will be tight in the 1980s. For example, DOE believes that the industrialized countries face the probability of a gradual decline in the availability of oil to the industrialized countries for four reasons:[9]

1. OPEC exports are likely to decline. Domestic consumption in OPEC countries is rising at 10 percent annually. Thus even if production remains constant, exports would fall 2 mbd over the decade.
2. OECD production will not grow. Expected increases from new discoveries involve five to ten year lead times, and thus will not offset declines in older fields in that period. Net U.S. production is expected to decline by at least 1 mbd by 1985.
3. Soviet Bloc imports will grow. At best the Soviet Bloc will shift from net exports of 1 mbd to merely covering its needs by 1985. It might need imports of 1 mbd.
4. Developing countries' production will grow, but the contribution to world markets will be limited by their rapid growth of consumption. Production will increase gradually in Mexico, China and Egypt, but the net effect will be only a slight decline in net oil imports of all non-OPEC developing countries over the next few years.

This conventional wisdom does not go unchallenged. William Brown and Herman Kahn argue, for example, that "it is likely that in the not too distant future we will be witnessing major oil gluts, tumbling OPEC prices, and sharply reduced OPEC shipments...Barring wars, insurrections, or replays of the Iran debacle in other countries, there is no reason to expect endless increases in oil prices."[10] But to bar the role of accidents or political disruptions is to miss the central problem of the changing international energy situation. It was such political events that produced the enormous price spikes of 1973 and 1979. And it is such political events which pose the central and unpredictable problems in the future. Essentially, one cannot understand the changing nature of the international energy situation unless one sees it in a broad political context.

B. The Changed Political Context of Oil

In 1970, world oil was still governed by and large by a loose international regime that might be termed "guided laissez-faire." It had two essential components. First, price and production decisions were largely made by major international oil companies for essentially their own commercial reasons. Second, the major powers (particularly the U.S. and Britain) ocassionally intervened diplomatically to guarantee access for companies and generally oversee the process. With a few exceptions, these governming arrangements were stable and generally accepted. There seemed to be no real alternative.

One result of the regime was that oil prices and production levels tended to reflect supply and demand conditions in major consumer countries rather than the expected long term scarcity value or political considerations in producing countries. As low cost Middle East oil became more plentiful in the post war period, most of the difference in value between its low cost of production and the high cost of alternative sources of energy went to consumers who enjoyed low and declining oil prices. This was of great benefit to the Japanese economy, and the government deliberately encouraged increasing dependence on cheap imported oil.

A second result of the regime was that U.S. (and other countries) energy security policy could maintain a low profile. Even Europeans and Japanese with a longer tradition of thinking about oil as a security problem were lulled into increased dependence on Middle East oil. Basically, supply was assured by efficient operations of the companies under a Pax Americana that invovled only an occasional diplomatic assurance of access.

The changes in the regime by the end of the 1970s were dramatic. Prices and production levels were being set by producer governments rather than international companies, and for political as well as commercial motives. Such decisions were difficult to predict and did not follow a stable or recognizable set of international rules. Producer rather than consumer countries were capturing a large part of the difference between low costs of production and higher costs of alternative replacements for Middle East oil. The companies were increasingly constrained by governments at both ends of their pipelines, and their assured access to crude oil under predictable long term contracts diminished. Moreover, guarantees of access and oversight of price and production decisions had become widely regarded as absolute sovereign prerogatives of producer governments rather than the Major Western powers.

The result is that control over prices, production and to an increasingly extent distribution channels, has largely passed to OPEC countries. Historically, OPEC price increases have generally reflected market tightness more than their accompanying political rhetoric would imply, but models of OPEC countries behaving as economic maximizers are too simple. While economics can tell us a lot about demand in energy markets, it tells us only part of the story about supply in a world of sovereign states. Production decisions are made on a national basis and often reflect domestic political conflicts and decisions about matters as diverse as development plans, desirable social trends, and how to cope with external events. For example, in 1979 following the Camp David signatures, Saudi Arabia's political decision to reduce production to 8.5 mb/d in April contributed greatly to the market's turbulence.

Earlier it had helped to make up the missing Iranian oil but the Saudi cutback shook assumptions about future production levels and contributed to the panic buildup of stocks in a tight market that drove prices to record levels.[11]

Moreover, production decisions are affected by prior investments in capacity that may reflect internal political conditions of years ago. It appears that Saudi slowness in developing capacity a few years ago may have been designed to avoid pressure for higher production from the United States which would have been embarrassing in inter-Arab politics. The result was that the 1979 cutbacks by Iran and by smaller producers (who were traditionally price-followers) occurred in a relatively tight market where revenues actually increase as production declines. Current reported Saudi efforts to increase capacity toward 12 mb/d might be interpreted as an effort to regain its position of power within oil markets. But we do not fully know the determinants of Saudi behavior. Revenue needs and foreign policy positions provide clues, but it may be that oil production decisions really reflect shifts in internal royal family coalitions in which the guiding principle is to minimize the sense of domestic and international political pressure and threat felt by the royal family.

Nor can one be certain about the domestic politics of other producing states. Reserves and revenue needs provide clues, but only part of the political story. One would expect Mexican production, for example to increase on that basis. But rates of increase will reflect internal politics. Mexicans worry that too rapid growth of oil exports will create inflation and a high priced industrial structure unable to export and unable to meet their employment problem. Similar political arguments over economically amd socially desirable production levels occur in such developed allies as Norway and Britain.

Even if projections of a tightening market prove wrong, a softer market would not remove the danger of production cutbacks due to revolutions, accidents or sabotage which are beyond the producer's control. If consumers again ignore the political fact that production decisions have moved under the control of the producer governments, we may be condemned to repeating the costly 1970s cycle of disruption raising prices; high prices causing a temporary glut; renewed crisis and severely disruptive price increases. Faced with risk and uncertainty in production decisions, it behooves us to be sceptical about all projections and to carry considerable insurance!

C. Policy Implications of Projections

In thinking about insurance, it helps to sort energy security problems into short term (inside two years); mid-term (2 to 10 years); and long term (beyond a decade) as the following table illustrates.

Table I: Time Horizons and Energy Security Problems

	Time	Dominant Problem	Some Major Solutions
1. short term	2 years	how to cope with potential oil supply interruptions	stockpiles, demand restrai
2. mid term	2-10 years	how to reduce independence on Persian Gulf Oil	conservation;c gas; non-OPEC
3. longer term	10 years+	how to adjust to higher priced alternatives	As above plus thetics, nucle solar

These categories are rough, and the remedies overlap. But they help to show, for example, that synthetic, nuclear and solar programs have long lead times and provide only minor parts of the solution to the short term and midterm energy security problems. Oil is the heart of the energy security problem, and will remain so for at least the next decade. For example, even if the U.S. and Japanese nuclear programs proceed as now planned, they will provide only about 10 percent of total primary energy in each country by 1990. (Only the French program is far enough along to have the potential to rise from a current level of 5 percent of total energy to 20 percent by 1985). Of course, excess electrical capacity is some help in the short run. When there is unused electricity capacity, there is room for a certain amount of fuel switching for heating purposes in the short and mid-term. But such programs should not be confused with the major measures such as stockpiles which do the most to solve short run problems.

Similarly, it is estimated that the ambitious U.S. synthetic fuels program may produce around one million barrels per day (six percent of current oil consumption) by 1990. This does not mean that such efforts to create alternatives are irrelevant to energy security. On the contrary, they indicate some eventual limits to oil price increases. This, in turn has some moderating effects on current prices by affecting arguments inside OPEC nations about the value of keeping oil in the ground. But whatever their long term values, a dollar invested in synthetics is worth much less for short run interruptions that a dollar invested in stockpiles.

Price and security considerations sometimes work in opposite directions. Some actions which raise prices, for example building reserves, also increase security. Moreover, one effect of higher prices is increased conservation which reduces dependence. This is not to say that high oil prices are unimportant. Quite clearly they are and efforts to moderate them are important. High prices themselves can produce important security costs - witness the dangers of instability in the international banking system or in particular countries such as Turkey or Korea. Prices cannot be ignored, but the largest prices increases have been precipitated by the '73 and '79 supply crises. A sensible approach to the future oil market is to seek price moderation but not at the cost of forgetting the dangers of interruptions where the biggest numbers are.

In recent years, proposals have been made to invade the oil fields, break OPEC, nationalize the oil companies, set up a new international organization; engage in the collective bargaining, and so forth. None of these is a realistic solution. They only divert attention from the difficult job of integrating a broad range of domestic and foreign policy instruments, and building effective cooperation among key consumer governments. Unfortunately, the one clear projection is that the broad issue of energy as a security problem will be with us well into the coming decade or longer.

III. Japanese and U.S. Energy Policies

A. The Evolution of Japanese Policy

Before 1973, Japanese energy policy concentrated primarily on price rather than security of supply. Low energy prices were a key part of the government's economic strategy of encouraging investment in heavy energy intensive industries.[12] Cheap imported oil was favored over indigenous coal or hydroelectric resources. This conscious decision to increase import dependence produced a dramatic shift from 26 percent dependence on imported energy in 1955 to 46 percent in 1960 and 90 percent when the oil crisis struck in 1973.

Oil policy was based on the local refining of imported crude. Under the Petroleum Industry Law of 1962, MITI was given authority to license entry into refining, approve production plans and set standard prices. The Ministry of International Trade and Industry (MITI) used this authority to encourage entry of Japanese firms into refining (14 firms in 1950 increased to 38 in 1979), while discouraging any concentration by oil majors or the general trading companies. This fragmentation of the refining industry was designed to keep domestic petroleum product prices low. In addition, MITI discouraged price rises in kerosene which was politically sensitive as a home heating fuel.[13]

Internationally, Japan relied primarily on the large multinational companies (the Majors) for supply, and the international oil market was in a condition of glut. While MITI sought to promote exploration by Japanese companies, it did not develop a single national champion company, and it gave little special support to the Japanese capital Arabian Oil Company that had been privately established in 1958. In the early 1970s, as international markets began to tighten, and in line with a diminishing emphasis on heavy industry, a new MITI minister increased efforts to reduce dependence on the Majors and to foster exploration by Japanese banks and trading firms through subsidies from the Japan National Oil Corporation that had been created in 1967. However, in 1973, the Majors still supplied 80 percent of Japan's oil.[14]

The 1973 Arab oil embargo dealt a severe shock to Japan. Previous politically instigated embargos in 1956 and 1967 had been buffered by surplus American capacity. Moreover, Japan was shocked that its low diplomatic profile in the Middle East had not sufficed to keep it off the Arab nations' list of unfriendly nations. The initial Japanese response was a voluntary 10 percent conservation program by industry, and closing of gas stations on holidays. Subsequently, Japan tried to relieve its energy security problem by altering its foreign policy. On November 22, Japan urged Israel to comply with Arab demands and threatened to "reconsider its policy toward Israel."[15] Coming right after a visit by Secretary of State Kissinger, this action was widely regarded as the most serious breach in bilateral relations since the war.

Although its diplomatic efforts (including visits to the Middle East and promises of aid) earned Japan a transfer to the "friendly list" by December 25, they did not really solve Japan's problem. The real relief came through the efforts of the international oil companies to direct supplies in a manner that equalized the impact of the crisis. Contrary to popular political belief in Japan, the actions of the companies meant Japan suffered less than other countries, with only a three percent shortfall below forecast supplies compared to an 11 percent shortfall for the United States and a 19 percent shortfall for Europe.[16] By the time of the Washington Energy Conference in February 1974, Japanese officials who realized the advantages of cooperating with the United States prevailed, and Japan was active in launching the IEA and its Emergency Plan that was agreed upon the following September.

Following the 1973 oil crisis, Japanese energy policy headed in the right direction though its pace was rather restrained. Some of the conservation effects of the initial price increase were limited by exchange rate changes which subsequently reduced the costs of crude oil imports to Japan. On the demand side, price controls instituted in 1973 were officially removed in 1975. Nonetheless, MITI continued to shelter kerosene and jet fuel from the full effect of rising prices. By 1977, prices of personal consumption items such as gasoline and kerosene had doubled over their 1970 level; roughly in proportion with consumer prices in general. But since there was a 50 percent rise in real incomes over the same period, the effects on personal incomes and increased energy prices was not severe. In the case of industry, heavy oil prices rose to three times their 1970 level (in comparison with a 69 percent increase in the wholesale price index over the same period).[17] In addition, MITI acted to discourage further domestic expansion of weak industries such as copper smelting and aluminum refining, that were energy intensive. In the three years after 1973, Japan's overall energy consumption per real unit of GNP went down by 10 percent. Between 1973 and 1978 while gross domestic product grew 3.6 percent per year, total primary energy consumption grew by 1.2 percent; oil consumption .4 percent; and oil imports declined by .9 percent.[18]

On the supply side, the Japanese government launched ambitious programs in nuclear and renewable energy sources. Project Sunshine, initiated in 1974, focused on developing solar, geothermal, coal conversion and hydrogen technology.[19] It s original target was 1.6 percent of total energy supply in 1990. The original 1970 nuclear program called for 60 gigawatts (GW) by 1985, but as a result of siting problems and lengthening construction times, this had to be revised downward to 30 GW. Coal imports remained stagnant. Imports of liquified natural gas (LNG) rose from 3 to 14 million tons of oil equivalent (mtoe) from 1973 to 1978. Thus it was clear that supply problems would continue to center on oil.

The government took a number of steps in relation to the security of oil supply. In 1973, Japan had only 45 days of imports in stock. New legislation required companies to hold 90 days in stocks (the I.E.A. target) by 1980 and planned to build government stockpiles to 20 million kiloliters by 1985. MITI, if not public opinion, became less restrictive toward the Majors, while at the same time increasing government subsidies for Japanese firms to explore abroad. By 1980, however, such firms produced only 10 percent of Japan's oil imports. Diplomatically, the government fostered ambitious aid and investment programs in oil producing countries, and negotiated a number of direct government to government agreements for purchase of oil. At the same time, Japan cooperated with the United States both in bilateral R&D arrangements and multilaterally through the I.E.A.

The Iran crisis of 1979 dealt Japan a second oil shock. As the majors were cut off from their traditional sources of crude oil by Iran and other OPEC countries, they had to curtail sales to third parties in order to supply their own affiliated refineries. Since Japan had discouraged large refining efforts by the Majors, many of the third parties cut off were independent Japanese refineries. Whereas the Majors provided 70 percent of Japan's supplies in 1978, they had fallen to 56 percent in September 1979 and 44 percent at the beginning of 1980.[20] The result was a sense of intense vulnerability and panic on the part of Japanese firms who were willing to pay extreme spot market prices and to submit to extraordinary contract terms. In addition, their continued build up of stocks out of fear of future political uncertainties helped to exacerbate the market tightness initiated by the Iranian events.

B. Current Japanese Strategy

The 1979 Iran crisis produced a renewed commitment to reducing oil dependence and devising a strategy to cope with the unavoidable security problems. The goal of Japanese energy policy is to reduce oil dependence from the current 75 percent level to 50 percent by 1990 and to increase oil from Asia above its current 20 percent share of total oil imports. In concert with other developed countries at the Tokyo Summit in July, and at the I.E.A. Minsterial Meeting in December, 1979, Japan joined in establishing oil import ceilings. Japan's target was set a 6.3 to 6.9 mbd in 1985 allowing a 17 to 28 percent increase from the current 5.4 mbd level. Subsequently, the Japanese government announced its intention to meet the lower target level. Japan' strategy to achieve these goals includes measures to diversify energy sources; measures to restrain demand; and measures to enhance security of oil supply.[21]

The following table shows the planned changes in energy supply.

Table II: Japan's Planned Changes in Energy Supply

	Per Cent Share in Total Energy Supply[22]			
	1977	1985	1990	1995
Oil	75	63	50	45
Coal	14.8	16.1	17.8	18.3
Nuclear	2	6.7	10.9	14.3
LNG	2.9	7.2	9	8.7
Hydro	4.8	4.7	4.6	4.6
Solar, geothermal, etc.	.1	1.3	6.5	9.4

Oil will remain the dominant energy source, but coal, nuclear, and gas are scheduled to increase from 20 percent to 30 percent by 1985 and 38 percent by the end of the decade. While this performance would still leave Japan dependent on oil and on imported energy, the diversification of fuel types and sources of imports will reduce the degree of Japanese vulnerability to particular events in fragile areas such as the Persian Gulf.

The targets for alternative energy sources are ambitious. Domestic coal production is to be maintained at the present 20 million ton level, but imports of steam coal will have to increase from the current level of 1 million tons to 53 million tons by the end of the decade. Coal fired thermal plants will be encouraged and new oil fired plants discouraged. Large investments are planned in overseas coal development; import infrastructure and for conversion to coal burning facilities in the cement and other industries.

On nuclear energy, Japan hopes to expand its present level of 15 gigawatts to 30 in 1985 and 53 in 1990, as well as lay the basis for a complete fuel cycle. LNG imports are scheduled to increase from 14 to 45 million tons by the end of the decade. The 1974 "Sunshine Project" of R and D in new energy sources such as solar and coal liquefaction is now supposed to account for 5 percent of total energy supply by 1990. In 1980, the Japanese government increased its energy budget by 30 percent to 740 billion yen. Special funds and a "New Energy Development Authority" are being established to promote alternative energy sources.

Unfortunately, these targets for alternative energy supplies are unlikely to be achieved unless current government politics are changed. The following table prepared by Toyoaki Ikuta, president of Japan's Institute of Energy Economics presents his personal estimate of alternative energy supply in 1990. The realism of Ikuta's estimates are confirmed by other private Japanese sources such as the Industrial Bank of Japan.[23]

Table III: Two Projections of Alternative Energy Supply in 1990

			Government's Program	Ikuta's Realistic Estimate
Hydro	GW		26	20
Domestic Coal	MT		20	18
Geothermal	GW		3.5	0.6
Domestic Oil and N. Gas	MT		9.5	9.5
Steam Coal Import	"		53.5	28 √ 33
LNG	"	83	45	32
LPG	"		26	15
Nuclear	GW		[illegible]	[illegible]

The largest absolute shortfalls are predicted in nuclear and in steam coal imports. Japan has 15 GWe of nuclear capacity operating and 5 more under construction. Another 10 to 15 are currently approved or about to be approved, but construction has not started. Since construction time now takes close to ten years, it would be hard to change the nuclear total for 1990.

There might be more flexibility in the use of steam coal imports if government policy changes. Japan currently uses oil to generate some 53 percent of its electricity While it is MITI policy not to approve new utility applications for oil burning plants, there are 20 oil burning plants under construction and another 13 approved in the blueprint stage.[24] The result is that Japan would continue to build new oil burning plants through 1986. The main obstacle to more rapid conversion is local political and environmental concerns. MITI is currently engaged in consultations which may produce a consensus on more rapid conversion from oil to coal, but since Japan uses ten times more energy per unit of habitable land area than the United States, these space problems are not trivial.[25]

While the news on the supply side may be worse than the government estimates, the demand side may turn out better than expected. Pessimists argue that Japan's energy consumption per capita of 3.2 tons of oil equivalent is well below the IEA average of 4.9 or the U.S. figure of 8.2. With rapidly rising personal income, consumers may want to purchase more air conditioners, appliances and larger homes. Moreover, the pessimists argue that because industry represents a high 58 percent of total energy consumption (compared to 32 percent in the United States), and many Japanese industries are already comparatively more energy efficient than their counterparts in other countries, that there is little room left for conservation. The more optimistic view points to the greater price responsiveness of industry; the flexibility of Japanese industry in purchasing energy intensive components from abroad; MITI's encouragement (along with prices) of a shift of industrial structure toward a less energy intensive direction; and the current pattern of rapid investment in new energy saving processes.

The early returns favor the optimists. Total energy consumption, and gasoline use declined in the first half of 1980, despite rising economic growth. Japan may well exceed its conservation goals of saving 15 percent of what would otherwise have been the energy consumption level in 1990.[26] A new Energy Conservation Act passed in October 1979 requires large factories to appoint energy managers who must report regularly to MITI; provides tax incentives and assistance; and sets building and vehicle efficiency standards. In addition, in February 1980, the government announced short term measures such as reduced room heating and automobile use in an effort to curtail oil consumption by 7 percent. During 1979, the gasoline tax was increased by 25 percent, the aviation fuel tax was doubled, and kerosene prices were deregulated.[27] In 1980, electricity prices were raised 50 percent, and individual customers pay a high rate of 13 cents a kilowatt hour.[28]

The government has also taken a number of measures to deal with possible oil supply interruptions. Its required 90 day level of private stocks was surpassed in early 1980. Buildup of public stocks, however, lagged behind schedule because of difficulty in finding storage sites and difficulties in obtaining oil for official reserves under tight market conditions. At present, the Japan National Oil Company has about 33 million barrels (approximately 7 days of imports) stored in 20 surplus tankers.[29] It plans to recommence purchases for the stockpiles as prices soften. The government target is 120 million barrels (roughly 20 days imports) in storage by 1982 and a 40 day government stockpile by a later unspecified date.

In addition, the government has undertaken diplomatic steps and encouraged business ventures designed to assure access to oil supplies. These include government to government oil deals (e.g. with Mexico); energy and related industrial investment projects in OPEC countries (such as petrochemical plants in Saudi Arabia and Iran) as well as exploration projects in Communist countries (China and USSR) and OECD countries (e.g. Canada). Development assistance (for example to Indonesia) is also designed to help assure access to oil supplies. Finally of course, Japan is an active participant with the United States and others in the I.E.A. with its emergency sharing plan.

C. The Evolution of U.S. Policy

During the two decades before 1973, the main preoccupation of American energy policy was with the glut of inexpensive oil on world markets. World oil production increased steadily, despite political perturbations and the low cost of Persian Gulf oil posed a problem to higher priced American domestic producers. U.S. antitrust actions and the entry of new independent firms into the international market prevented the major companies from effective collusion to raise prices.

Faced with rising import levels, a Cabinet Advisory Committee recommended in 1955 that voluntary measures be followed to maintain the existing ratio of imports to domestic production. Intensified voluntary restraints were recommended in 1957, and in March 1959, President Eisenhower instituted mandatory quotas to keep oil imports at roughly 12 percent (with regional and product exceptions).[30] While the import quota program had an explicit national security goal, it also had a strong protectionist origin. As a security measure, the program has been criticized for stimulating artificially high production levels that eroded domestic reserves, rather than creating stockpiles and spare capacity.

In 1970, a Cabinet Task Force recommended the gradual elimination of quotas. Ironically, this occurred at the same time that U.S. domestic oil production was peaking at 11.2 mb/d. By 1973 imports had risen to 30 percent of oil consumption. U.S. spare capacity of 4 mb/d in 1960 had represented 44 percent of U.S. demand and 21 percent of Free World demand. By 1970, U.S. spare capacity of 1 mb/d represented less than 1 per cent of U.S. demand.[31]

Thus, unlike Japan, U.S. policy before 1973 ostensibly focused on security, but in reality was concerned about price, although again unlike Japan, the concern was to protect rather than merely lower prices in the domestic market. Nonetheless, during the 1960s, the price of oil dropped by 10 percent relative to other goods and consumption rose by 5.4 percent per year in the late 1960s.[32]

Like Japan, the U.S. was ill prepared for the 1973 oil embargo. Under tightening market conditions in the early 1970s, the government attempted to play a conciliating role in bargaining between OPEC countries and the major companies, but it did little diplomatically or in energy policy to effectively prepare for an embargo. During the embargo, the U.S. government encouraged oil companies in their efforts to equalize the burden:

stepped up its Middle East diplomacy; and took the lead in organizing the International Energy Agency. Domestically, a Federal Energy Administration was established. It administered a system of oil price controls and direct allocation of oil among refiners which did little to improve the situation. Public attitudes tended to blame the Nixon Administration and the oil companies for the crisis.[33]

Between 1974 and 1979, the official goal of U.S. energy policy was to reduce dependence on imported oil. Ironically, the effects were the opposite, as imports rose from 6 mb/d in 1974 to 8 mb/d in 1978. The system of domestic price controls subsidized oil imports whose higher prices were blended in with the lower prices of controlled domestic oil. The U.S. strategy rested on the expected efforts of the enormous 1973 price increase in stimulating the new supply; restraining demand, and eventually reducing the real price of imports. At one point, for example, U.S. diplomacy in I.E.A. was focused on establishing a floor price so that cheaper oil would not destroy incentives for investing in long term energy alternatives. To an extent, the strategy worked. Energy efficiency in industry improved ten percent from 1973 to 1977; and the real oil price dropped by 25 percent from 1976 to 1978. But the price gains were more than wiped out by the aftermath of the Iranian events in 1979. In the meantime, the lower prices had perverse effects on political will and consumer demand restraint, and the increased imports of Persian Gulf oil exacerbated the energy security situation.

The focus on price rather than security contributed to the divisive nature of the political debate over energy in the U.S. In 1977, when President Carter announced his first energy plan which eventually led to relaxing price controls on natural gas and increased incentives for conservation, the general public did not believe his statement that a more restrictive energy policy was the "moral equivalent of war." Development of alternative energy sources such as coal and nuclear were also slowed by the drop in the demand for electricity and by political problems regarding siting and safety.

D. Current U.S. Strategy

The Iranian Revolution dramatized the fragility of the political assumptions behind the previous American energy policy. Pressing fragile Persian Gulf governments for ever increasing levels of production might help on price in the near term, but it increases vulnerability over the longer run. The most important change precipitated by the Iran crisis, was the April 1979 decision for phased decontrol of oil prices by September 1981. This was followed by the U.S. agreement at the Tokyo Summit to hold future oil imports to a ceiling of 8.5 mbd. Subsequently, the President set a goal of cutting oil imports in half by 1990 while maintaining a growing economy.[34] The 1980 ceiling was set at 8.2 mbd. Other post-Iran initiatives include a major synthetic fuels program, subsidies to encourage conservation and solar energy; and subsidies for the conversion of oil fired facilities to coal.

The following table, comparable to the previous table about Japan, presents the U.S. Department of Energy's projection of future energy sources.[35]

Table IV: U.S. Targets for Change in Energy Supply

	Per Cent Share in Total Energy Supply		
	1978	1985	1990
Oil	50	40-43	33-38
Gas	25	23-24	21-22
Coal	17	23-24	28-31
Nuclear	4	7-8	8-9
Other	4	3	4-5

Oil production is expected by DOE to remain near current levels of 9 to 10 mb/d with depletion of conventional production in the lower forty-eight states offset by new production from Alaska, shale oil, and enhanced recovery. (It is worth noting that oil industry sources see a dip to 7.1 mb/d of conventional and synthetic in 1990 before levels of 11 mb/d are achieved again by 2000).[36] DOE projects a decline of gas production from 9 to 8 mb/d oil equivalent by 1990. Coal production is expected to continue its rapid growth from the record 775 million tons or approximately 8.4 mb/d oil equivalent to 13 or 15 mb/d oil equivalent by 1990. Nuclear energy is projected as increasing from the current 50 gigawatts to 150 to 200 gigawatts by 2000, a slippage to half the level projected a few years ago. Renewables are expected to increase from 1.5 to 2 mb/d oil equivalent by 1990.[37]

Demand restraint also plays an important role in U.S. energy strategy. Rising prices seem to have already had a beneficial effect. Total U.S. energy consumption in 1979 was static, and gasoline consumption 5 percent lower although GNP rose by 2.3 percent. In comparison, between 1973 and 1978, U.S. energy consumption increased by 1 percent per year. and oil consumption increased 1.6 percent per year.[38] Industry sources estimat that U.S. energy consumption in 1980 will be 6 mb/d less than it would have been if pre-1973 price and consumption patterns had continued. These savings could reach 16 mb/d in 1990 with sectoral demand reduced by 21 percent for industry; 39 percent in transportation; 25 percent in residential commercial; or 27 percent overall.[39]

In addition to price effects, the government plans to spend one billion dollars on conservation information, R&D, grants to state and local governments. In addition, some $700 million in conservation tax credits will be granted. Conservation regulatory programs include efficiency standards for automobiles, buildings, and appliances.

In December 1975, legislation was enacted to establish a strategic Petroleum Reserve (SPR) of up to 1 billion barrels to reduce vulnerability to supply interruptions. The fill of the SPR has been behind schedule, with almost no fill under the tight market conditions and delicate diplomatic situation in the Persian Gulf after the Iranian revolution. In 1980, Congress mandated a resumption of fill of at least 100,000 barrels per day. The current level is 92 million barrels, or approximately 12 days of imports. The revised schedule calls for 250 million barrels by 1983 and 750 million barrels in storage by 1989.[40]

IV Major Energy Issues and Recommendations

A. Nuclear Energy

At present, nuclear energy represents a small proportion of total energy supply - a few per cent - in both the U.S. and Japan. However, by the end of the decade, it is projected as providing just under and over 10 per cent of U.S. and Japan's total primary energy respectively. This is equivalent to 4 mb/d of oil in the U.S. and 1 mb/d in Japan. However since a large part of this electricity would otherwise be generated by coal (particularly in the U.S.) the effectson world oil would be smaller than these numbers imply. In the past, Japan's nuclear energy industry depended heavily on the U.S., but steps to develop an independent industry and fuel cycle have been underway since the late 1960s. Even with greater independence, however, Japan will still depend on fuel imports (both natural and enriched uranium); and the nuclear industry worldwide will remain interdependent in terms of public reactions to issues of safety and non-proliferation. As the Three Mile Island accident in 1979 demonstrated, there is a common interest in the proper handling of such volatile public issues.

In 1977, nuclear energy became one of the most divisive issues in the relationship.[41] Since this was the most serious dispute in the energy relationship to date, it deserves attention and provides some useful lessons. Essentially, the issue began when the linkage between nuclear energy and non-proliferation of nuclear weapons was dramatized by the 1974 Indian detonation of a device using materials obtained from Canada and the U.S. for peaceful purposes. Alarm was further increased in the U.S. Congress by French and German plans to provide reprocessing plants which could extract weapons- usable plutonium from spent reactor fuels in Korea, Pakistan and Brazil. This period of anxiety and turmoil after 1974, helps explain many provisions of the subsequent U.S. Non-Proliferation Act of 1978 which has been frequently criticized in Japan.

In the eyes of the Americans, events in the international nuclear energy arena were like bicycles speeding down hill without brakes and approaching a sharp curve as plutonium fuels replaced the familiar (and, less readily weapons-usable) low enriched uranium fuels. The policy objective was to put brakes on the bicycles - to buy time to strengthen institutions and technology before accidents occurred in the curve. The wide spread of facilities involving weapons usable materials - in 1974 the International Atomic Energy Agency (IAEA) projected some 46 countries using plutonium by 1990 - before insitutional and technical improvements were in place, would almost certainly have ruptured the international safeguards regime that had been so laboriously constructed over the previous two decades. While the nuclear fuel cycle was not the only path to weapons capability, the U.S. had evidence that some countries intended to misuse allegedly peaceful facilities. Thus, in October 1976 President Ford announced policy changes toward the use of plutonium in the U.S. and in April 1977, President Carter extended this policy and called for an international nuclear fuel cycle evaluation (INFCE) to study the timing, risks and institutional opportunities for various aspects of the peaceful uses of nuclear energy.

For Japan, insecurity of energy supply loomed much larger than any military insecurity related to proliferation. The salient event of 1974 was not the Indian explosion, but the aftermath of the Arab oil embargo. In the eyes of Japanese officials, the relevant bicycle metaphor would be a cyclist crossing a desert with only a small canteen of water and no time to lose before reaching the other side. The fact that the use of plutonium fuels in existing reactors would not significantly reduce Japanese dependence on imported oil during this century, simply reinforced Japanese beliefs in the need for haste. They feared that any questions, pauses or alterations in an earlier plan might fracture the fragile social consensus underlying nuclear energy. And the government had just promised peaceful nuclear benefits to the Diet if it ratified the NPT.

Thus when President Carter announced that the United States was going to defer reprocessing and the use of plutonium in existing reactors, and would restructure its breeder reactor and R&D program to stress safer fuel cycles rather than early commercialization, there was considerable consternation in Japan. To make matters worse, Japan was just in the final states of completing its first pilot scale reprocessing plant at Tokaimura, and the existing agreement for nuclear cooperation between the United States and Japan provided for U.S. approval rights over any Japanese reprocessing of fuel that had originally come from the United States. Thus, at the same time that President Carter was deferring the reprocessing of U.S. fuel at home (over the strong opposition of American industry and some Congressional critics), he was being asked to make an exception to permit the Japanese to do what U.S. industry was not allowed to do at home. The domestic politics of the issue became heated in both countries. Eventually, a compromise was reached which allowed the plant to start up on a limited basis.

The Tokai crisis served to intensify a broad range of consultations between Japanese and Americans on nuclear issues both bilaterally and in INFCE. One effect has been the beginning of a convergence of perspectives as Americans became more sensitive to Japanese energy security concerns and Japanese began to perceive their other security interests involved in the proliferation dimensions of nuclear energy. Fortunately, Japan's own intentions were never an issue, and the alliance partners shared an interest, albeit unequally weighed, in both the energy security and military security aspects of the nuclear proliferation problem.

Before addressing the substance of the nucelar issue, it is worth noting some lessons that can be learned from this case.

First, the U.S.-Japanese alliance reflects deep interests in both countries. Because it is rooted in reality, it has resilience. While shocks occur, there is also an awareness of the importance of the relationship that helps contain the effects.

Second, tensions are bound to exist in the alliance because the military and economic resource situations of the two countries are so different. It is inevitable that their positions and perceptions will often differ - witness the relative weighting of the two dimensions of security.

Third, in the past Japan has tended to seek special exceptions to universal rules. Less attention is paid to the burden of leadership in setting and maintaining rules which are required if stable international regimes are to govern global issues. In addition to seeking exceptions, in the future Japanese national interest should be defined more in terms of sharing the global problems involved in the leadership in establishing and maintaining international regimes.

Finally, both countries need to pay more attention to the manner in which they conduct their dialogues. Large delegations, formal meetings, and high level summits probably produced more misunderstanding than real communication in the early stages of the nuclear issue. Some of the most fruitful communications were the small and informal ones.

The prospects for avoiding a recurrence of tensions in the nuclear issue are quite good. As a diplomatic device, INFCE postponed divisive decisions, but it also helped to re-establish a basis for consensus on a refurbished regime for the international nuclear fuel cycle. Although the final report was a massive body of negotiated language some of which differed from purist versions of the U.S. positions on plutonium, it also contained a set of technical conclusions which support an evolutionary approach as a potential point of political compromise internationally as well as in the Japan-U.S. relationship.

While no single fuel cycle emerged on its technical merits as indisputably more proliferation resistant, a general basis was laid for caution in introducing weapons-usable fuels. Working Group I agreed on a range of projected demand for uranium by the end of the century that was one half to one third of the internationally accepted figures before INFCE started. This helped reduce the anxiety that characterized disputes over uranium resources, since it had the same effect as doubling uranium resources.

In addition, Working Group 8 identified modest improvements (15 percent) that could relatively easily be made in the efficiency of uranium consumption.

As for the use of plutonium, Working Group 4 found that recycle in thermal reactors is not likely to have significant economic advantages and Working Groups 6 and 7 found that safe storage or disposal of spent fuel does not require reprocessing. Working Group 5 concluded that plutonium will be needed for breeder reactor programs, and that successful breeder programs will be based on large nuclear energy programs (such as Japan's) but not in the small programs where economies of scale cannot be achieved. The net effect of these findings is to reduce the pressures for the wide-spread and present use of plutonium in thermal reactors in some 20 countries and direct its use toward R&D for future breeders in a small set of countries most of which are not proliferation risks.

INFCE laid a basis both in time and institutional suggestions for a cautious introduction of plutonium guided by realistic development needs rather than a dangerous spread based on uncertain economics and exaggerated projections. It also laid a basis for Japan-U.S. compromise based on Japanese use of plutonium (including plutonium of U.S. origin) for breeder and advanced reactor research and development while deferring a decision on commercial plutonium recycle in light water reactors.[42] Part of the compromise would involve U.S. and Japanese efforts to develop multilateral institutions for a rigorous plutonium storage system; spent fuel storage, and improved safeguards. It could be supplemented by bilateral cooperation in longer term fuel supply contracts and reactor safety research programs.

While there are people with more extreme positions in each country who could disrupt this INFCE based compromise, the nuclear issue should not become divisive again if these positions do not prevail.

B. Coal

Compared with nuclear energy, the problems in the coal issue are more straightforward and less directly political. Coal currently accounts for 15 percent of Japan's and 17 percent of U.S. total energy consumption. Over this decade, coal's share is planned to increase to 18 percent in Japan and approximately 30 percent in the U.S. This will represent about 2 mb/d of oil equivalent in Japan and 10 mb/d in the U.S.

A massive investment in coal production and trade will be required. The Director of the I.E.A. has called for a tripling of world coal production by the end of the century (a 5 percent increase each year), and the annual movement of 700 million tons in trade (roughly the equivalent of current American coal production or current Saudi oil production).[43] To meet such targets, American exports will have to increase from 54 million tons of coal equivalent to 81 million by 1990. Japan's imports will have to increase from 60 million to 142 million tons of coal equivalent over the same period. Similar projections are made by the World Coal Study which sees a tripling of world coal use and a 10-15 fold increase in world steam coal trade as an essential bridge from the current energy situation to the energy sources of the next century.[44]

The immediate problem is massive investment in coal production, transporation and utilization facilities which have 5 to 10 year lead times. Underlying this investment problem is the political problem

Secure access to markets in Japan is vital for increased investment in coal export infrastructure in the United States. Conversely, Japanese utilities must be reassured that imports under long term contracts will not be disrupted for commercial or political reasons. Given the political sensitivity of environmental and transportation issues related to coal in the United States, such assurances are doubly important. A useful start was made at the Tokyo Summit in June 1979 where the political leaders pledged to "maintain positive attitudes towards investments in coal projects and "not to interrupt coal trade under long term contracts unless required to do so by a national emergency."

The importance of close Japan-U.S. cooperation in coal is underscored by the structure of the industry. Concentration in world coal is even higher than in world oil. Ten countries account for 90 percent of currently estimated reserves, and there are only seven significant exporters. On the other hand, the two countries with the largest potential are the United States and Australia. The United States alone accounts for some 50 percent of world coal produced outside Communist areas. According to the World Coal Study, "in the long run, because of its abundance, and provided a fee and competitive international market is maintained, there is little reason to expect that steam coal prices will be directly coupled to world oil prices. This will be particularly so as oil is increasingly removed from the heating market for use in transport as a specialized petrochemical feedstock."[45]

Coal provides unique security advantages to Japan. While it involves imports, they can be diversified among politically stable countries such as Australia, China, and the United States. America's alliance concern for Japanese energy security helps to make a "coal OPEC" unlikely. There is little prospect of a political accident disrupting supply as in the case of Persian Gulf oil, or of a nuclear accident in some country sending its political shock waves to Japan. As mentioned earlier, some of the major constraints on coal use arise in Japanese domestic politics as well as international factors. Both private and governmental cooperation (such as increased joint work on liquefaction) can help to reduce such constraints in both the short and long run.

C. Oil

Even if the ambitious goals for alternative energy are met in both countries, oil will continue to be the dominant source of energy supply in both countries at the end of the decade, representing at least 50 percent of Japan's and 33 to 38 percent of American consumption. In 1990, total U.S. oil consumption is projected to be 14 to 17 mbd with Japanese consumption at 6.2 mbd. Because of the interdependence in price and security described above, oil will remain the most important energy issue in the U.S.-Japan relationship.

In their past policies, both countries have tended to focus on price questions. Even after the shock of 1973, insufficient steps were taken to develop strategies for energy security in chaotic situations such as occurred in 1979. Yet as the earlier discussion indicated, the "big numbers" are in the security domain. The costs of large supply interruptions can be in the hundreds of billion dollars as well as involving direct damage and foreign policy costs. Ironically, though this is the area of greatest effects, it is also the area where existing procedures of consultation are least developed. Given the small amounts of oil actually lost in 1979, much of the damage to our economies was due to the consumer government's inadequate cooperation.

A strategy to deal with supply interruptions of the type that occurred in 1979 (or which might result, for example, from terrorism or local wars) requires a blend of energy, diplomatic and military policies. Steps can be taken to deter, defend and restore flows of oil as well as alleviate the effects of an interruption. The following table illustrates the general components of a strategy.

Table V: Policy Instruments for Chaotic Interruptions

	Domestic	Foreign
Deter Actions		Diplomatic and Military Posture in Persian Gulf
Defend Flows		Intelligence and Assistance
Restore Flows	surplus equipment	Repair capacity and airlift
Alleviate Effects	Public and private stocks Demand restraints Emergency Procedures	I.E.A. Sharing Plan Coordinated Demand Measures Coordinated Diplomacy

In the past, for understandable historical and political reasons, Japan has been reluctant to become involved in many of these measures in the foreign policy domain. While no one should expect Japan to play a military role, former Foreign Minister Miyazawa has observed that "the

Japanese have only recently become aware of the fact that a major economic power cannot shun a certain degree of political responsibility.[46] Since actions of any sort in the Persian Gulf are bound to have a strong effect on Japan, it would be in Japan's as well as American interests to develop bilateral and multilateral consultation procedures that encompass a broad range of energy security measures rather than just the narrow technical issues. This point is elaborated below.

In addition to an increased general attention to broader consultation on the security dimensions of oil supply, a number of specific steps may be needed to deal with specific aspects of the problem. First, attention should be given to the changing role of the major international oil companies in supplying the Japanese market. As indicated earlier, the Majors' share has declined to about 40 percent of the Japanese market and may decline still further. Contrary to popular belief, the Majors have tended to play a political stabilizing role in time of crisis. Their ability to switch oil between sources and destinations in their complex global distribution systems diminished the effectiveness of political embargos and provided an equalizing mechanism for burden sharing which governments would have difficulty in reproducing.

By acting as a buffer between politics and oil allocations, the Majors helped to reduce frictions between governments. As their role declines, the prospect rises that such frictions will burden the intergovernmental relationship. Moreover, the emergency sharing plan of the I.E.A. rests upon the capabilities of the 34 reporting companies for implementation. If these companies become too small a part of the Japanese market, doubts arise about the implementation of the oil sharing plan

Whether anything can be done to halt the decline in the role of the Majors is an open question, but certainly one worthy of government attention. In addition, attention should be devoted to the possible role of the Japanese General Trading Companies and Japanese capital oil companies in supplementing the role of the Majors in implementation of the I.E.A. sharing plan. In particular, the Japanese Government should prefer dealing through such companies rather than deliberately expanding the role of government to government deals. The latter provide only an illusory security, and by removing the arms length buffer that the private companies provide, government to government deals open Japan to greater degrees of political pressure on its foreign policy by oil exporting countries.

A second specific issue is stockpile policy. As described above, both the United States and Japan have private and public stockpile policies for emergencies. Since such stocks are called upon when interruptions would cause sharp rises in the price of oil, they can have a significant effect in reducing economic costs of an interruption as well as protecting against direct damage and foreign policy costs. The benefits from calling upon such stocks in a time of crisis are shared through the market by more than the country which has built the stocks. Similarly, the costs of building such stocks in tight markets are shared by all buyers. Consequently, there is a strong case to be made for consultation on stock building and early release policies if they are to have maximal effects and minimal costs.

Currently, as described above, both Japan and the United States are behind schedule in the building of their public strategic reserves, in large part because of tight market conditions following the Iranian events. At the same time, private stocks have been built to high levels in both countries. Indeed, this private stock building contributed to the market tightness which hindered filling the public reserves. In the normal commercial cycle, such stocks would be sold off as markets and political tensions ease. Yet, national security interests go beyond commercial interests, and measures to encourage or assist in the carrying of large private stocks can be an important complement to strategic reserve policies.

A third area for consideration is the role of Alaskan oil and the possibility of developing it in a way that can be called upon in time of crisis. More through nationalist political sentiment than economic rationality, Congress imposed restraints on the export of Alaskan oil except if the I.E.A. emergency plan is invoked. It would be wise to amend the U.S. legislation in a manner that would permit export of Alaskan oil to Japan, either without conditions, or under smaller emergency conditions with a system of swaps for oil purchased elsewhere. This would provide transportation savings and would be more consistent with efforts to deal wit small interruptions (discussed below). The amount of oil involved is less significant than the adverse effects on confidence in Japan. However, should political shortsightedness make such a change impossible, alternative ways of sharing oil (for example diverting U.S. imports from Indonesia to Japan) can produce the same energy benefit in a crisis.

A fourth matter for attention is strengthening of the I.E.A., particularly its ability to deal with small scale interruptions under the 7 percent threshold that triggers the sharing plan. The I.E.A. oil sharing plan provides for demand reductions in time of crisis followed by an equal sharing of the burden of lost supply. Market forces and the Majors would tend to produce the same effect of shifting oil to the points of greatest shortage in a time of crisis if there were no government interference. What the I.E.A. agreement does is legitimize these equalizing forces, and create a presumption against government interference. It is certainly in the interest of Japan as a large importer and of the United States as an alliance leader, that the I.E.A. mechanisms be properly maintained.

Japanese sometimes privately express concern about whether the United States would really use the I.E.A. in an energy emergency. The answer depends in part on the type of emergency. Table 6 presents a range of energy security threats and appropriate domestic and international responses.[47] The United States and Japan are already cooperating in the I.E.A. on the ceilings and other measures appropriate to meet the first problem of large price increases. At the other extreme, the largest potential threat, the loss of all Persian Gulf oil (number 6 in the table) would be a catalytic political event that would probably call forth special ad hoc measures. The I.E.A. Sharing Plan is in place to deal with embargos or interruptions that exceed 7 percent shortfalls. (numbers 2, 3, and 5 in the table). There is reason to believe that the Plan would work. Technically, the amount of oil that would need to be reallocated is well within the amounts handled by the reporting companies. Politically, sharing

TABLE VI

Energy Security Threats and Consumer Government Responses

I. Extortions	Domestic Measures	International Measures
1. large price increases	Demand restraint Alternative supplies High stocks	Import ceilings (up to a point) Encourage extra capacity Encourage alternative supplies
2. extraneous political pressures	Demand restraint High stocks	Consumer sharing if selective embargo Political-Military counterpressure
3. Embargo	Demand restraint High stocks	IEA Sharing Plan Political-Military counterpressure Coordinate SPR use and tariff/taxes
II. Interruptions		
4. Small c.2 mbd	Demand restraint by price or tax Modest SPR use	Encourage surge capacity use Repair/restore capacities Informal (below 7%) IEA plan: a. stock release b. informal sharing c. restraint in market
5. Large c.8 mbd	Demand restraint by price or tax Major SPR use	IEA Sharing Plan Coordinate SPR use and tariffs/taxes Repair/restore capacities
6. Huge c.20 mbd	Demand restraint by rationing Emergency marginal supplies Full SPR use	Ad Hoc Summit and allocation Political-Military repair restore

is based on long run self interest, since the alternative is that we share the remaining oil anyway through competitive bidding, reaching the same outcome at higher prices and with a shaken alliance.

There is a major gap, however, in cooperative procedures for dealing with small interruptions such as the 1979 events that fail to reach the 7 percent I.E.A. trigger (number 4 on the table). The United States complained about Japanese behavior in tight markets, but provided little help. As matters stand after the May 1980 I.E.A. meeting, the secretariat has the power to call an emergency ministerial meeting when it finds market disruption, and the ministers can agree to curtail demand by converting the current "yardsticks" of appropriate national import levels into national ceilings. But three further steps are needed. First, the governments should agree to some release of stocks to dampen sharp price increases. Second, governments should bilaterally or through the I.E.A. secretariat ask the oil companies to assure that minor shortfalls are evenly distributed. Third, governments should agree to ask corporations to try to restrain exceptional bidding in tight markets. Had some such plan for informal use of the I.E.A. mechanism been in place in 1979, the economic damage that both Japan and the United States suffered could have been greatly reduced. A hopeful step in the right direction was the high level assurances of equalization of any shortfalls arising from Iranian sanction that the United States gave Japan in the Spring of 1980.

D. Procedures for Consultation

A great deal of consultation in energy matters already occurs between the United States and Japan. At the highest levels it occurs at the annual economic summits and their preparatory mechanisms. At ministerial level, there are bilateral visits as well as multilateral meetings in the I.E.A. context. At the technical level, the U.S. and Japan have bilateral cooperative arrangements in fusion, coal conversion, high energy physics, solar and geothermal, as well as other energy areas. Multilaterally they cooperate in more than a dozen energy fields through the programs and projects of the I.E.A. Nonetheless as indicated earlier, some aspects of the energy relationship fall between these stools, particularly the broader security aspects of energy interdependence.

The governments should consider new bilateral and multilateral procedures for improving their consultation and cooperation in the energy area. Bilaterally, a ministerial level joint commission on energy and a standing committee on energy security would help to integrate the various aspects of the current cooperation and put them into broader security context that might make it easier to deal with a number of the detailed frictions that are bound to rise. Certainly, the processes of consultation and communication regarding spot market purchases; Middle East diplomacy and Iranian sanctions were not as smooth as might have been wished during the past year.

Multilaterally, it might be useful to create an energy security group under the summit mechanism; or to establish such a group at ministerial level in the context of the OECD/IEA framework. Such devices could permit French participation. It would also be important that such a group include both energy and foreign policy officials so that it would focus on the broad aspects of energy security that are not now captured in the I.E.A. framework. The exact nature of the suggested mechanism is less important at this point than is directing government's attention to the gap in the existing procedures and the value of finding a way to fill it.

These bilateral and unilateral consultation procedures could be usefully supplemented by non-governmental and quasi-governmental measures such as Keichi Oshima has suggested.[48] A joint institute might organize a network of the many private energy policy research projects in the two countries and bring them to bear on central policy problems in the relationship. A joint U.S.-Japan energy policy forum composed of business, academic and government participants might receive such reports and pass their recommendation on to the formal inter-governmental bodies. A forum could also help in exploring solutions to problems that may arise. Such a group which was convoked three times by the Japan Atomic Industrial Forum and the Ford Foundation played a useful role in introducing flexibility into the nuclear dispute between the two countries.

Given their scale in world energy markets, frictions are bound to arise in the energy relations between the United States and Japan. But with wise domestic policies and improved coordination, these frictions should be manageable and need not disrupt other aspects of the relationship. Indeed energy could become an area of enhanced cooperation that could benefit the relationship as a whole.

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COOPERATION OF JAPAN AND THE UNITED STATES IN ENERGY

(Supplement to the paper "Energy & U.S. - Japan Relations")

by

Keichi Oshima
The University of Tokyo

1981

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1. Implication of the United States and Japan Cooperation

As described by J.S. Nye, Japan and the United States are the two largest energy consuming countries in the world and the share of oil in their energy consumption is high. Also, dependence of their oil import from OAPEC countries are quite substantial. The recent political and military instability in the region of oil producing countries have increased the vulnerability in energy supply of the two countries in respect to national security and sound economic development critically. Furthermore, considering the role of the United States and Japan in the free world petroleum consumption, a change in energy policy of either country could have a tremendous impact on the world energy supply and demand situation, affecting economic prosperity and political stability.

On the other hand, as regards to energy supply, the United States has large natural energy resources, and in the international political relations, the United States is taking lead as superpower. Japan has scarcely any indigenous energy resources in its country and Japan plays little leadership role in the international relations of military powers.

The fact that Japan and the United States have a common goal of reducing their vulnerability in oil supply and maintaining stability of the world economic and political situation, and the fact that energy policies of the both countries have a crucial influence on the future of the world show that cooperation between the United States and Japan in energy is not only important to both countries but is essential for solving the energy problems of the world. In fact, the growth of Japanese economy has increased the role and responsibility of Japan in the international community and also, because of its close relationship to the oil producing countries as one of the largest oil importers in the world, the Japanese energy policy has to be formulated not only with reference to the interests of Japan but also fo the whole world community.

However, as described by J.S. Nye, past events have shown that even though Japan and the United States are in accord regarding the ultimate goal of their energy policies, their short term interests do not necessarily always coincide, and there is a possibility that their policies may come into conflict. In the recent case of Iran, Japanese energy policy was based on primarily economic considerations and did not necessarily agree with those of the United States, whose major concern was in the political realm. Another example was in nuclear policy where the U.S. non-proliferation policy ran counter to Japan's emphasis on nuclear power as quasi-domesti alternative to oil. The negotiations regarding Tokai Reprocessin

Plant disclosed the initial disagreement of the both countries on the fast breeder reactor (FBR) program and the use of plutonium, although eventually a compromise was reached.

Energy policies of all countries have become increasingly interdependent. Especially, the interdependence among the advanced industrialized countries is so great that any action taken by one major country in energy policy would have a marked impact on the others. At the same time, energy problems are of great domestic interest in each country since they are so significant for everyday life and economic activity. In many cases, energy policies based on domestic interest can lead to international friction. On the other hand, energy policies agreed in the international negotiations can be politically unrealistic unless due consideration has been given to the interests of domestic groups.

Therefore, in order to carry out meaningful energy cooperation between Japan and the United States, it is essential that the both governments have not only a comprehensive agreement on objectives, but also agree on specific energy policies based on careful assessments and mutual understanding of international situation as well as domestic interests and circumstances of each country. Otherwise, ironically, cooperation can lead to bilateral conflicts.

2. The Need for a Broad Cooperative Framework

Although cooperation of the United States and Japanese governments in the energy field has to be considered in a comprehensive and integrated manner, for discussion purposes, we will consider four major areas:

(1) oil, in dealing with current urgent problems;
(2) coal, which will be a major alternative for oil in the coming years; (3) nuclear power, another major alternative for oil; and (4) research and development in new energy sources, which can lead to possible solutions of energy problems in the future.

Oil is the most urgent economic issue for the two countries as well as a highly political issue of national security. As often pointed out, the present oil supply and demand situation is not a result of a lack in resource but rather a consequence of the international political situation. Therefore, oil policy should be considered in the framework of a much broader security perspective between Japan and the United States. Oil problems cannot be isolated from the bilateral political relationship; they are closely related to Japan's role in the international security alliance of Western countries. In an economic context, Japan is highly dependent on oil supply because of scarce domestic resources and limited possibility for switching its oil demand to other sources.

The oil supply and oil price have a strong direct impact on the economic and social well-being of Japan. The energy problem should not be dealt with solely on the basis of quantity; it must also be considered in the light of an economic policy based on price factors and the market mechanism. At the moment, Japan is in the process of adjusting its industrial structure and activities to higher oil prices. If Japanese industry can successfully adjust its production structure to higher oil prices, Japan's vulnerability in the international oil market will be reduced and incentives for developing alternative energy can be increased. Japan, therefore, prefers price mechanism to prevail in the world energy market; in other words, economic rationality is the strongest concern to the Japanese government.

Historical differences can be seen in the energy policy of the United States and Japan. The United States, which has a strong domestic oil industry, has tried to protect its oil resources and oil industry and also has enforced rigid price control in the interest of consumers. On the other hand, Japan, whose domestic oil supply is close to absolutely none, has always tried to maintain the market mechanism and economic rationality, with less government control on price, as bases of its energy policy in the past. In order to have a cooperative energy relationship between the United States and Japan, especially in a period of transition from oil to other resources, this fundamental difference in the two countries' energy policies has to be carefully considered. There will have to be an understanding and agreement on the interests that both countries will expect from the cooperation.

In seeking alternative energy sources to oil, there is a natural difference between the United States, which has one of the largest coal reserves in the world, and Japan, which has to import practically all of its coal supply. And this leads to different approaches to alternative sources, both from security and economic viewpoints. For example, in the coming 20 to 30 years, both countries have a common goal to reduce their oil consumption and imports by introducing alternative energy for industrial and household uses. However, while it is possible for the United States to reduce its oil import and be independent of OPEC supply, it is not feasible for Japan to substitute completely its oil import with other sources, and thus, for Japan, imported oil will remain a major source of energy until the 21st century. Also, when we consider that major use of alternative energy, whether coal or nuclear, will be for generating electricity, the situation in Japan and the United States is quite different. Over 70% of electricity generated in Japan relies on imported oil, and only 4% on domestic coal. In the United States, more than 50% of its electricity is generated by domestic coal. As a consequence, the two countries have a fundamental difference in their interests when faced with the choice of coal or nuclear as an alternative energy source. Japan will most likely consider nuclear as the major alternative energy rather than coal. This is reflected in the nuclear policy of the country.

Different emphasis is placed on the role of nuclear energy in the future energy supply scenario of the two countries. In the United States, there seems to be a strong opinion that nuclear energy should not be considered the major energy source for the future but an interim source until other major supplies such as solar or fusion are developed. On the other hand, Japan has a much stronger faith in nuclear energy as a major energy source until at least the middle of the 21st century.

This means that the two countries will agree on the overall importance of nuclear and coal as an alternative energy, but on the level of specific policies and measures, interests will differ and can even be in conflict. This is another case where the common objective has to be clearly defined and specific individual items or issues related to each energy source such as coal, nuclear, or even oil.

If the cooperation aims to agree on some specific local problems without considering the broader framework of the alliance, the arguments over individual issues can lead to fundamental conflicts and work against the common interest of the both countries. An outstanding example is the recent argument over non-proliferation and nuclear power policy. Although the United States' non-proliferation policy was aimed at some sensitive countries, disagreements over the policy were raised between the United States and its allies, namely Japan and Europe, once the U.S. tried to apply its non-proliferation policy worldwide. The work of INFCE and its outcome, which is not binding on any country, is valuable in the sense that Japan and the U.S. could appreciate each other's position and achieve a compromise. As seen from the post-INFCE actions of the both countries, non-proliferation is fundamentally a political matter and cannot be treated simpl as a technical problem such as safeguard technique and fuel cycles. The most important issue for the both countries is to agree on the political framework in which the non-proliferation policy can be promoted. The nature of problem is not to find a general structure for a new regime, but rather how the United States, Japan and the allies can deal politically with specific sensitive countries such as Iraq and Pakistan. Therefore, cooperation in nuclear policy should start from agreement on the common political objectives rather than negotiating specific issues such as enrichment, reprocessing, and fast breeder.

As for coal, it has been proposed that cooperation between the U.S. and Japan be achieved by Japan giving a guarantee of long-term coal market large enough for the United States to carry on investment and construction of transportation system and long-term coal production. Apparently, this seems to be profitable for both sides because Japan will obtain security in coal supply, and the United States will gain incentives and guarantee of profits for making long-term investments in the coal industry. This seems to be a reasonable proposal for coal. However, Japan will wish to have a much more flexible position of buying coal from mainland China, Australia, and others, for political and economic reasons, than to be bound to the United States. A commitment of a long-term procurement from the Unites States may narrow the future options of Japan and not necessarily be the most desirable solution. In addition, the political constraints on construction of coal fired plants based on environmental considerations should be taken into account. For this reason, the utilities in both countries feel reluctant to commit heavily to coal.

As seen in these examples, cooperation between the United States and Japan has to be viewed from a broader perspective of comprehensive interests of the both countries. Such interests may alter as the political and economic situations change -- very rapidly in some cases. On the other hand, energy policy has to be consistent and based on a long-term interest because the energy problem is basically long-term in nature.

3. Government and Private Enterprise

In the cooperation between governments, emphasis is usually placed on fundamental national policies of the governments; the role of the private sector is sometimes not given enough consideration. Cooperation in energy is different from defense or space where government is the major actor. In energy, major actors are private enterprises. Energy is a raw material and resource for economic and social activities of a nation. In the United States and Japan, where free enterprise and the market mechanism are the fundamental principles of the economy, energy industry takes the form of many private enterprises rather than a national enterprise as in some countries. At least in Japan, there is a strong preference to maintain the energy industry in the private sector. Therefore, agreements between governments in energy cooperation have to be implemented eventually by private enterprises as commercial activities. However, the role of governments in energy sector is likely to greatly increase in the future. The policy and schemes of cooperation of the two governments may thus have a tremendous impact on the future activities of private enterprises in energy.

For example, in the case of U.S. non-proliferation policy in nuclear power, it looked as though the priorities of the government and industry were quite different. The U.S. nuclear industry has played a major role, historically, in the development of the Japanese nuclear program. In this regard, strength of the U.S. nuclear industry is of major concern for the Japanese nuclear program. If the U.S. industry declines, this can have a detrimental influence on the Japanese nuclear program. Also, agreements of the governments for non-proliferation could have restrictive repercussions for cooperation of the nuclear industries of the two countries, if not properly formulated.

For coal, even if the two governments agree on a cooperation policy in which Japan would guarantee a long-term purchase of coal from the United States, if political considerations distort those of economic rationality, there can be difficult problems for private sector. For example, typical questions will be who should buy the coal and what is the justification for private enterprises to sacrifice their economic interests for political reasons. Some schemes have to be developed in cooperation between the governments and the private enterprises.

In the research and development cooperation, which is becoming more active in recent years, the relation between government and private enterprises can become a critical issue in the future. Government-owned patent rights and their implications for private enterprises are different in the both countries. Also, the relation between the government and industry in research and development sponsored by the government is historically different in the United States and in Japan. Therefore, when a joint research and development project between the both governments successfully reaches the stage for commercialization, there may be disagreement in the policies of the both sides as regard to arrangement with industry. This problem is not necessarily unique to United States-Japan relations. There was already some difficulty at IEA when the United States proposed cooperation in energy R & D by establishing a consortium composed of governments and major enterprises because the treatment of patents and relationship of industry and government in many of the IEA member countries were different.

The relation between the government and enterprise in energy sector can have fundamental impact on the whole economic and industrial activities of the nation. In this regard, in order to have efficient and effective cooperation in energy, the both countries should agree beforehand on the proper relationship between the public sector and private industry and the role of the private sector.

4. Cooperation in Research and Development

Cooperation in research and development will be one of the most important means for the both countries to solve the energy problem and for their contribution to the establishment of stabl worldwide political and economic energy situation. Multilateral cooperation in R & D through IEA is already underway. Also as a result of initiative taken by President Carter and former Prime Ministers Fukuda and Ohira, bilateral cooperation between the U.S. and Japan is becoming increasingly active. Here again, the overall objectives and comprehensive strategy for R & D should be agreed upon by the both countries before undertaking specific programs. R & D projects have different implications depending on their time schedule and objectives. For example, research and development programs of a long-term nature such as fusion and large-scale solar electricity generation aim at achieving a major technical breakthrough to supply ample energy not only for the both countries but for the whole humankind. Therefore, the objective is not necessarily a commercial implementation of the project in the short term. In this case, cooperation between the governments is straightforward and major decisions to be made will be how both countries share resources, manpower, and activities. Because the main actors of such a project will be the governments, even the participation of private industry will be under government contract; industrial initiatives by the private sector will come at a later stage.

Other R & D projects on use of coal, nuclear and biomass as alternative energy to oil should play major roles in the coming 20 to 30 years. In these projects, setting clear targets for timing of commercialization and meeting economic conditions such as cost and investment are crucial. R & D in these types are part of the overall energy policy of the country since whatever new technology being developed has to be applied and commercialized as major energy sources for industry and daily usage. Therefore, priorities will not be based on attaining technical superiority but on meeting practical energy objectives as a whole. The decision will need to reflect economic goals as well as the impact on society, the environment and other more general issues. As repeatedly mentioned, the basic and long-term objectives of the two countries in energy are in common; only individual energy policies related to different sources such as coal, nuclear and oil differ due to specific interests of the both countries. Under such situation, there has to be an agreement in the overall strategy of the R & D cooperation. For specific projects to proceed successfully to larger scheme of commercialization requiring greater investment and manpower, reasonable decisions will only be possible within an agreed framework of overall strategy; otherwise, the success of research and development can be hampered by conflict at the stage of implementation. This does not necessarily mean that there should be a decisive agreement on details from the beginning, but at least, there has to be a mechanism for making timely assessment of the stage of development and evaluation of how this can be applied in the energy policy for the benefit of each country. Continuous consultion on how the program should be continued and directed should play a vital role.

It is important to have a body responsible for coordinating and assessing the whole R & D cooperation between the American and Japanese governments in relation to the overall energy policy of each country and in the general framework of bilateral cooperation. Unfortunately, at present, cooperation in R & D between the two countries seems to be proceeding at the initiative of specialists in the field and government officials in charge of specific projects, rather than with overall consideration and assessment of a broader R & D strategy. There is a need to have a mechanism to coordinate and assess each project and establish a set of priorities for such projects in the light of common interest of the both countries.

5. Relations with Developing Countries

Energy cooperation between Japan and the United States has an impact on the relations of the both countries with the developing countries of the Third World. Especially under the present situation where oil-producing countries are asking for technology transfer in return for supplying oil, and oil-deficient developing countries are requiring aid in energy technology from industrialized countries to solve their problems, cooperation and transfer of technology from Japan and the United States to such countries are becoming an increasingly important issue, although technology transfer has always been a major issue in the North-South relations in general. As typically observed in the case of nuclear technology, technology transfer cannot be treated just in the economic context of aid to these countries because of its significant implications for security and political relationships. Technological cooperation to developing countries cannot be disengaged from the overall international policy of the both countries. Therefore, an agreement between Japan and the United States in their approach to the developing countries, especially in technology involving sensitive security and political implications, will be important for future cooperation and alliance of the both countries in order to avoid unnecessary international conflict. A detailed study needs to be conducted on how transfer of technology to developing countries influences both political security and economic stability. One important consideration to be taken in such study is that restriction of transfer may serve only as a temporary measure because technology can always be supplied competitively from other industrialized countries. Study should encompass specific geographic areas and countries on the one hand, and deal with general relationship between technology transfer and investment or aid to these countries on the other.

6. Recommendations

To conclude, a few specific recommendations are proposed as follows:

(1) U.S.-Japan institute for energy policy studies.

In order to strengthen energy cooperation between the United States and Japan, it is essential to have clear understanding and agreement on the overall energy policies as well as specific policy-actions to be taken by the two countries.

For this purpose, it is recommended to establish a joint U.S.-Japan institute for study on energy policy which will carry out studies on general policies, such as impact of energy policy on the overall political and economic relationship, and also specific issues such as coal, nuclear, and R & D cooperation. The institute should be sponsored by equal contributions from the American and Japanese governments and composed of researchers from the two countries. At the initial stage, permanent research staff can be about 30 members composed of an equal number of U.S. and Japanese researchers acting as the core group. The area of studies can be divided into energy politics, energy economy, and R & D. Substantial part of the studies should be contracted out to research groups outside the institute belonging to universities, reaearch institutions and other organizations. These research groups can be a U.S.-

-Japan joint team. The initial budget would be about 10 million dollars per year with half of the amount being contracted out. Coordination and synthesis of the studies should be done by the core group. Also aside from the core group, part-time researchers from Japan and the United States may participate in the studies.

The institute will contribute to the general U.S.-Japan political and economic cooperation because energy is related to broader aspects of political and economic interests of the countries. In the future, the institute may be extended to cover joint scientific and engineering research in energy projects.

(2) Joint U.S.-Japan energy forum composed of private sector and governments.

Cooperation in energy has to be proceeded by concerted effort of the government and private sectors of the two countries. The role and interests of the private enterprises have to be well coordinated with the government policies. It is proposed to set up a joint forum of private sector and governments of the two countries in order to meet such requirements and avoid conflicts of the two. There exists already some organizations such as the Atomic Industrial Forum, the Trilateral Commission, and others. The recent most successful forum of such kind was the U.S.-Japan joint workshop on nuclear policy which have met three times in Japan and the United States during the period of INFCE, sponsored by the Japan Atomic Industrial Forum, the Ford Foundation and afterwards the Rockefeller Foundation. The workshop had 20 to 30 members from each country, including members of government, industry, the Diet and some Congressional staff. All attended the meeting in private capacity and the meeting was closed to outsiders to encourage frank discussions on nuclear issues. The workshop was very successful in increasing understanding on both sides and could have substantial influence on the policie of the two countries to avoid conflict and reach compromises. However, these organizations do not cover the entire area of energy nor are they held on a continuous basis. Therefore, a new forum for continuous consultation concentrating on energy issues will be desirable. The forum should be supported financially by non-governmental sources and have a secretariat to serve as a continuous contact point to the two sides. Membership can be 20 to 30 or more, meeting once or twice a year, and representing a broad area from academia, government and industry, to politicians or their aides, all of whom will be asked to attend the meeting in their personal capacity and discuss important issues which are of mutual interest or root of possible conflict to the two countries. The work of the secretariat may be delegated to some existing forum or organization.

The Sources of Decline in U.S. Productivity Growth

Scott Davidson
Staff, Japan-United States
Economic Relations Group

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I. Importance of Productivity Growth: A Review

A. Introduction

Productivity is the real output per hour of work. High productivity growth can increase competitiveness, lower inflation, raise real wages and as a consequence improve the overall standard of living.

On the other hand, decreasing productivity fuels inflation, undercuts the trading position and the strength of the dollar and increases domestic pressures for protectionism.

B. International Productivity Comparisons

During most of the post World War II period, U.S. productivity growth rates have been significantly below those achieved by the major industrialized nations.

As Table 1 demonstrates, annual U.S. productivity growth averaged just over 1.5 percent in the last two decades. In most major European nations productivity growth rates have hovered around 4 percent. Japan achieved productivity growth rates of approximately 9 percent, until the 1973 oil crisis after which her productivity rates slowed dramatically, but remained the highest among the advanced industrialized nations.

Table 1

Productivity Growth Rates in Industrialized Countries

Country	1960-79 (1)	1960-70	1970-79 (1)	1960-73	1973-79	1976-77	1977-78	1978-79
US	1.5	2.0	1.1	2.1	.3	1.8	.2	-.3
Canada	1.9	2.3	1.3	2.6	.4	.6	.2	-1.2
Japan	7.1	9.5	4.5	8.9	3.4	4.0	4.6	4.6
Belgium	3.7	4.2	3.2	4.2	2.7	1.4	2.5	3.3
France	4.2	4.9	3.5	4.8	2.9	2.2	3.5	2.5
Germany	4.0	4.5	3.4	4.3	3.1	2.9	2.4	3.4
Italy	4.6	6.4	2.6	5.9	1.7	1.5	2.2	3.7
Netherlands	3.6	4.0	3.3	4.1	2.6	2.5	2.2	2.6
UK	2.4	2.7	2.0	3.0	1.1	0.9	3.2	0.4

Data for the latest year are based on preliminary estimates
Source: Department of Labor, Bureau of Labor Statistics

Productivity is an indicator of competitive strength. Especially important are productivity growth rates in the manufacturing sector since fiercest competition among the industrialized nations occurs in manufactured goods.

As Table 2 reveals, the annual rate of productivity growth in the U.S. manufacturing sector, like that in the overall economy has been almost the lowest among the industrialized nations.

The gap between manufacturing productivity growth rates in Japan and the U.S. is particularly striking. Between 1960-79, average annual manufacturing productivity growth rates in the U.S. were 2.5 percent compared with 8.3 percent in Japan. While productivity in the manufacturing sector dropped much more dramatically in Japan than in the U.S. after the 1973 oil crisis, by 1978 and 1979, the Japanese rates rebounded and surpassed the 8 percent mark. In the U.S. the comparable 1978-79 figure was an uninspiring 1.51 percent.

Table 2
Output per Hour in Manufacturing, 11 Countries, 1960-1979
Average Annual Rates of Change

Country	1960-79 (1)	1960-70	1970-79 (1)	1960-73	1973-79	1976-77	1977-78	1978-79
US	2.5	3.0	2.2	2.9	2.2	3.0	0.5	1.5
Canada	4.0	4.3	3.2	4.5	2.8	5.5	4.7	0.8
Japan	8.3	10.5	4.7	10.3	4.2	4.5	7.9	8.3
Belgium	7.3	6.4	7.5	7.0	6.6	5.6	5.7	NA
Denmark	6.8	6.8	5.5	7.2	4.6	2.1	4.0	1.1
France	5.6	6.1	5.0	6.0	5.1	5.0	4.9	5.4
Germany	5.4	5.7	5.4	5.5	5.0	5.4	3.4	5.2
Italy	6.1	7.1	4.6	6.9	3.3	1.1	3.0	8.7
Netherlands	7.3	7.1	6.2	7.6	4.9	3.8	5.1	NA
Sweden	5.5	7.0	3.0	6.8	1.7	-2.0	6.0	8.2
UK	3.2	4.2	1.8	4.1	0.6	-0.5	1.2	2.2

NA=Not Available (1) For Belgium and Netherlands, data related to period ending 1978.

Note: Data relate to all employed persons in the US and Canada; all employees in the other countries. Rates of change are computed from the least squares trend of logarithms of the index numbers.

Examining specific industry groups within the manufacturing sector in Japan and the U.S. pinpoints primary sources of Japan's remarkable productivity strength. See Table 3.

While the above data reveals that annual productivity increases in Europe and Japan outdistance those in the U.S., it must be borne in mind that the level of U.S. productivity is still the world's highest. In 1979, as Table 4 shows, the level of output in the U.S. was 1/3 higher than that in Japan and about 10 percent above Canada, France, Germany, and the Netherlands.

Table 3

Trends in Output per hour: Manufacturing,
Mining, Utilities and Selected
Manufacturing Groups,
1960-1979

Industry Group	Relative average annual output/Hour Growth Rates							
	1960-1972		1972-1975		1975-1978		1978-1979	
	U.S.	Japan	U.S.	Japan	U.S.	Japan	U.S.	Japan
All Manufacturing	3.1	9.8	0.9	4.7	2.6	8.4	0.9	12.1[5]
Iron & Steel	2.4[1]	10.4[1]	-0.1	6.4	3.9	6.7	n.a.	15.4
Fabricated Metal Products	2.0	9.6	-0.9	2.2	2.3	12.1	1.0	-0.1
Machinery[2]	1.7	11.8	0.0	6.4	0.5	9.6	1.2	19.4
Stone, Clay & Glass Products	1.4	7.5	-0.5	3.0	4.0	9.5	0.2	10.3
Chemicals & Allied Products	4.5	14.0	0.0	3.5	3.5	11.0	3.6	11.9
Petroleum Products[3]	3.6	14.9	2.3	1.9	3.7	1.7	-3.9	5.0
Rubber Products	2.4	7.7	0.7	9.0	0.2	11.5	1.5	11.8
Leather & Leather Products	1.7	3.5	5.8	3.8	0.2	0.8	3.7	3.6
Paper and Pulp	5.4	8.9	0.0	5.6	3.4	9.1	3.5	10.4
Textiles	4.6	4.4	1.7	3.2	4.6	7.5	3.4	3.9
Lumber & Wood Products	3.8	4.2	4.0	-2.3	-1.1	2.9	0.6	0.3
Food			2.0		4.0		2.2	
Tobacco[4]	3.0	6.4	2.2	4.9	3.9	0.3	-7.1	0.4
Mining	2.8	n.a.	-5.5	6.2	-1.8	7.1	-8.7	1.7
Public Utilities	4.0	n.a.	2.0	5.1	0.0	5.1	-3.8	5.3

Source: American Productivity Center

Footnotes:

1. 1964-72
2. For the U. S., machinery except electrical for years after 1972. For Japan, includes electrical and other machinery for all periods.
3. For Japan, includes petroleum and coal products.
4. Data sources: U.S. and Japan, and 1960-72, U.S. Bureau of Labor Statistics.
   U.S., 72-79, American Productivity Center (Grossman Total Factor Productivity Series, labor productivity measures
   Japan, 72-79, "Quarterly Journal of Productivity Statistics," Productivity Research Institute, Japan Productivity Center,
   Oct.-Dec. 1979 and earlier issues.
5. Figure shown is the JPC figure, to assure consistency with the several industry group data shown. In the U.S. Bureau of Labor Statistics' release dated 5/22/80, this figure was 8.3% (APC has requested a technical explanation for the variance, as earlier years data appeared similar in both source publications).

Table 4
Relative Levels Real Gross Domestic Product
Output based on international price weights
(United States=100)

Year	Canada	Japan	Belgium	France	Germany (1)	Italy	Netherlands	United Kingdom
				Gross Domestic Product Per Employed Person(2)				
1950	84.5	15.5	56.5	42.4	39.8	27.3	55.4	53.4
1955	87.8	18.8	56.5	45.4	48.1	30.1	57.9	52.2
1960	89.5	23.8	59.7	53.7	56.0	34.9	62.7	53.7
1965	88.8	31.1	63.0	59.9	59.7	40.7	63.7	51.9
1970	92.6	48.7	73.7	71.0	71.3	53.4	76.1	57.6
1975	95.7	57.7	83.2	81.7	79.1	55.0	85.7	57.4
1976	96.6	59.3	86.0	83.2	81.8	56.4	88.1	57.8
1977	95.7	60.6	85.7	83.5	82.7	56.2	88.7	57.1
1978	95.7	63.2	87.6	86.4	84.5	57.3	90.4	58.5
1979	94.9	66.4	90.5	88.7	88.0	59.1	93.7	58.9

(1) Excluding the Saar and West Berlin in 1950 and 1955
(2) Employment figures for the Netherlands are Dutch estimates of work-years of employed persons
Source: US Department of Labor, Bureau of Labor Statistics

The outlook for U.S. productivity growth compared to the other industrialized countries is not good. Projections indicate that France, West Germany, and Canada will surpass the U.S. level of productivity by 1984. Japan's level of output will just edge past that of the U.S. in 1992. See Table 5.

Table 5
Projected International Productivity Trends, GDP per employee
(Constant Dollar Basis, International Price Weights)

1. Level of Productivity (1978 U.S.=100)

Year	U.S.	France	Germany	Japan	Canada
1978	100.0	85.6	85.6	63.0	96.1
1979	99.1	88.2	88.1	65.8	95.1
1980	98.6	89.9	90.3	68.1	95.1
1981	98.9	92.6	93.0	70.9	96.6
1982	99.9	95.7	96.7	73.8	98.5
1983	101.4	99.2	100.6	77.2	100.5
1984	103.2	103.2	104.0	80.8	102.5
1985	105.3	107.3	108.8	84.7	104.5
1986	107.4	111.6	113.1	88.7	106.6
1987	109.5	116.0	117.1	93.0	108.8
1988	111.7	120.6	122.4	97.8	111.0
1989	113.9	125.5	127.3	103.1	113.2
1990	116.2	130.5	132.4	108.8	115.5
1991	118.5	135.7	137.6	114.8	117.8
1992	120.9	141.1	143.2	121.1	120.1

2. Productivity Growth Rates

Year	U.S.	France	Germany	Japan	Canada
1979	-0.9	3.0	3.5	4.5	-1.0
1980	-0.5	2.0	2.5	3.5	0.0
1981	0.3	3.0	3.0	4.0	1.5
1982	1.0	3.3	4.0	4.2	2.0
1983	1.5	3.7		4.5	
1984	1.8	4.0		4.7	
1985	2.0			4.8	
1986				4.8	
1987				4.8	
1988				5.2	
1989				5.4	
1990				5.5	
1991				5.5	
1992				5.5	

Average Rates:	U.S.	France	Germany	Japan	Canada
1979-85	1.0	3.3	3.6	4.3	1.6
1985-92	2.0	4.0	4.0	5.2	2.0

Sources: 1979 actuals OECD
1980 Best estimates using Economic Report of the President and OECD
1981-84 best estimates based on OECD and J. Kendrick, L. Klein, and W. Freund
1985-92. best estimates based on various reports of probable economic patterns
Basic data from U.S. Bureau of Labor Statistics, 1978

C. The Domestic Productivity Performance

Between 1948-1965, productivity in the private sector in the U.S. grew at 2.5 percent annually. From 1965-1973, the growth rate slid to 1.6 percent. Between 1973-1979 it was 0.8 percent. In 1978, it was -1.0 percent. See Table 6.

Table 6

Labor Productivity Growth, 1948-1979
(Percent change per year)

Sector	1948 to 1955	1955 to 1965	1965 to 1973	1973 to 1978	1978 to 1979
Private business sector	2.5	2.4	1.6	0.8	-1.0
Non farm	2.4	2.5	1.6	0.9	-1.1
Manufacturing	3.2	2.8	2.4	1.5	(2)
Nonmanufacturing	2.1	2.2	1.2	0.5	(2)

1 Preliminary
2 Not available
Note Data relates to output per hour for all employees.
Source: Department of Labor, Bureau of Labor Statistics.

It is not enough to look only at aggregate productivity growth rates for they obscure significant growth rate differences among the sectors in the economy. For example, in the period from 1973-1979 productivity fell at an average annual rate of 4.5 percent in mining, 1.5 percent in construction, while growing at 6.8 percent in communications, 2.1 percent in manufacturing and 3.1 percent in agriculture. See Table 7.

While productivity growth has slowed in almost all sectors, three quarters of the 1967-79 slowdown can be attributed to four sectors-mining, construction, utilities and retail trade. Construction alone accounted for almost 1/2 of the slowdown.

Table 7
Productivity Growth by Industry (1950-1978)
(Average Annual Percentage Change)

Industry	1977 Output Share [1] (percent)	1950-65	1965-1973	1973-1979	1977-78	1978-79
Agriculture	3.4	5.2	5.5	3.1	-2.2	4.6
Mining	3.0	4.0	1.9	-4.5	0.0	-8.5
Construction	5.1	2.5	-2.5	-1.5	-6.4	-5.4
Manufacturing:	27.4	2.4	2.4	2.1	0.4	0.7
Nondurable	10.9	3.1	3.1	2.1	1.5	2.2
Durable	16.5	2.0	2.0	1.5	-0.2	-0.2
Transportation	4.3	2.8	2.3	0.5	1.9	-1.8
Communication	3.0	5.5	4.6	6.8	6.5	1.7
Utilities	2.8	6.0	3.6	0.3	-2.0	-3.9
Trade:	19.8	2.3	2.6	0.8	1.3	-0.6
Wholesale	8.4	3.0	3.9	0.0	0.2	-3.1
Retail	11.4	1.9	1.9	1.2	1.5	0.4
Finance, insurance & real estate	15.9	2.0	0.5	1.1	-1.6	-1.7
Services	14.2	1.6	1.7	0.3	1.7	-1.1

1/ Share of private domestic output. Detail may not add to 100 percent because of rounding.
Sources: US Department of Labor, Bureau of Labor Statistics

II. Sources of Productivity Growth

A. A "Multi-Factor" Approach

What are the the reasons for slow or negative productivity growth? A prerequisite for reviving productivity is identification and measurement of the sources of growth.

Productivity growth is most frequently analyzed through "single factor" productivity measures. The final aggregate private sector output is divided by the number of person-hours used to produce that output. But this method inadequately reflects a whole array of relevant variables. Analysts have sought to identify and to measure the contribution of the other underlying variables through "multi-factor" or "total factor productivity" measurements.

A number of economists have devised multi-factor measurements. Based on the approach devised by John Kendrick the American Productivity Center has recently begun issuing quarterly indexes of "total factor" productivity for the private domestic business economy and for major segments and industries.[1]

Christainsen and Haveman, two University of Wisconsin professors of economics, recently did a comparative analysis of a cross-section of multi-factor productivity studies.2

Most of the studies that Christainsen and Haveman examined, compared productivity growth between two periods- the 1940's to the mid 1960's and the mid 1960's to the mid 1970's.

B. Identification of Causes of Growth

Twenty-five variables presumed responsible for productivity growth were identified and compared in the studies. Table 8 is a partial reproduction of the University of Wisconsin results. For ease of analysis, the 25 variables are regrouped into 8 categories below, representing eight major sources of productivity growth.

They are:

1. Fluctuations in Economic Conditions
2. Energy Price Increases and Investment Distortions
3. Capital-Labor Ratios and Inadequate Capital Formation
4. Declining Innovation and Research and Development Expenditures
5. The Regulatory Environment
6. Intersectoral Employment and Productivity Shifts
7. Changes in Labor Composition
8. Other Factors

1. Fluctuations in Economic Conditions

Business cycles are inevitable and their effect on productivity can be powerful. Erroneous government policy can exaggerate and exacerbate the detrimental effects of cycles on productivity.

Periods of inflation and recession are the most worrisome phases of the business cycle. In a recession, when demand falls, equipment and workers are underutilized and the purchase of new equipment is delayed. Also employers resist layoffs hoping for an early recovery so as to avoid rehiring and training costs in the post recessionary period. An excess of labor relative to output and demand develops and forces declines in productivity.3

The most harmful effect of inflation on productivity may be that it interferes with the rational calculations of businessmen. Unpredictable prices, wages, and interest and tax rates during bouts of inflation make rational planning impossible. As the late Arthur M. Okun, former senior fellow of the Brookings Insititution and a former chairman of the Council of Economic Advisers said, inflation, "disturbs a valuable set of institutions that economize on

Table 8

THE CHANGE IN THE EFFECT OF VARIOUS FACTORS ON PRODUCTIVITY GROWTH
(CONTRIBUTION IN PERCENTAGE POINTS OF VARIOUS FACTORS TO THE GROWTH RATE
OF PRODUCTIVITY IN RECENT YEARS MINUS THE CONTRIBUTION IN PAST YEARS)

AUTHOR FACTOR	Denison(a)	Denison(b)	Kendrick(c)	Siegel(d)	Mark(e)	
1. Labor market tightness				.2 (11%)		
2. Cyclical effects		-.4 (-40%)	-.6 (-40%)	-.4 (-22%)		
3. Weather, work stoppages	.2 (7%)					
4. Shfit from mfg. to services			-.1 (-7%)	0	1 to -.1	(67to -6.7%)
5. Shift from farm to nonfarm	-.4(-13%)	-.3 (-30%)			-.3	(-20%)
6. Shift out of self-employment			-.1 (-.7%)			
7. Changes in hours worked	-.3 (-10%)	-.1 (-10%)				
8. Labor force composition	-.1 (-3%)	-.3 (-30%)	-.3 (-20%)	.2(22%)	-.2to -.3	(-13to -20%)
9. Education	.4 (13%)	.2 (20%)	.2 (13%)			
10. Health and vitality		0				
11. Nonresidential structures and equipment	-.1 (-3%)	-.1 (-10%)		-.6(-33%)	-.2	(-13%)
12. Inventories	-.1 (-3%)	0				
13. Other capital						
14. Economies of scale	-.2 (-7%)	0	-.2 (-13%)			
15. Land	0	-.1 (-10%)	-.1 (-7%)			
16. Energy Prices				-.7(39%)		
17. Pollution abatement	-.4 (-13%)	-.2 (-20%)		0		
18. Other regulation						
19. Gov't. services			-.1 (-7%)			
20. Taxes				0		
21. Expectations				-.4(-22%)		
22. Formal advances in knowledge			-.15 (-10%)			
23. Informal advances in knowledge	-2.1(-68%)	.2 (20%)	0			
24. Diffusion of know ledge			-.15 (-10%)			
25. Residual factors			.1 (7%)		-.6to-.9	(-40% to -60%)
Total Change Explained	-3.1(100.0%)	-1.0(100%)	-1.5 (100%)	-1.8(100%)	-1.5 (100%)	

a. Compares nonresidential business income per employed person in 1973-76 vs. 1948-69
b Compares nonresidential business income per emplyed person in 1969-73 vs 1948-69
c. Compares private sector output per total factor input in 1966-76 vs. 1948-66
d. Compares private nonfarm output per person-hour in 1973-78 vs 1955-65..
e. Compares private output per person hour in 1966-77 vs. 1947-66.
The portion of the decline in productivity growth
not accounted for by the authors was assigned to the residual factors category
ccs: Denison (1978b) Kendrick(1978), Siegel(1979) Mark(1979)
Source: Christainsen and Haveman

information, prediction, and transaction costs through continuing employer-worker and buyer-seller relationships." 4

The mix of government determined fiscal and monetary policies also appears to be a source of productivity decline. According to Martin Feldstein, the traditional inflation curbing prescription of easy money and tight fiscal position is almost bound to fail. This policy promotes inflation, encourages consumption and discourages investment decisions which would promote productivity.5

2. Energy Price Increases and Investment Distortions

Both U.S. productivity and productivity abroad plummeted in the wake of energy price hikes. What link exists between the sudden and dramatic rise in energy prices and the sudden and rather unexpected fall in productivity?

Economists have attempted to find a correlation between these two phenomena. The results of their studies are mixed. It appears that energy price increases did play a role in driving down productivity growth, but not as signficant a role as most would have expected.

Coen and Hickman found that "Without the oil shock, the growth rate of potential productivity would have been 1.7 instead of 1.0 percent per annum in 1973-1978. The potential growth path would have been 3.0 percent higher by 1978, but the subsequent natural growth rates would have been unchanged" from those which would have prevailed without the oil shock. They conclude that "the principal effects of the energy shock on potential output growth were transitory and attributable to the resulting rise in the relative price of capital."6

Norsworthy, Harper and Kunze considered the impact of the oil shock on the capital-labor ratios. They determined that capital-labor ratios would have increased at an annual rate of 2.3 percent instead of at 1.7 percent if energy prices had not risen as they did. And they estimate that labor productivity would have risen about 0.18 percentage points a year faster in manufacturing during the 1973-78 period if the relative price of energy had not changed.7

3. Capital-Labor Ratios and Inadequate Capital Formation

Studies of the U.S. productivity slowdown consistently point to falling levels of capital formation as a pivotal factor in determining the rate of productivity growth. 8 A 1979 BLS study stated that the productivity slowdown between 1973-1978 "is dominated by the effects of reduced capital formation."9

As table 9 shows, only Great Britain devotes less of its GNP to capital formation than does the U.S. Japan, with the highest ratio of gross fixed capital formation to GNP among the industrialized nations also has the fastest average rate of productivity growth.

Table 9

Ratio of Gross Fixed Capital Formation to GNP

Period	US	France	West Germany	Italy	Nether-lands	UK	Japan	Canada
				(Percent)				
1969	18.1	25.4	24.1	20.1	24.3	18.3	35.1	21.0
1970	17.3	23.3	25.6	23.1	25.6	18.4	35.4	21.0
1971	17.7	23.6	26.4	20.2	25.7	18.3	34.2	22.0
1972	18.3	23.6	25.9	19.7	23.6	18.2	34.0	21.9
1973	18.4	23.8	24.5	21.2	22.8	19.1	36.6	22.5
1974	17.8	24.5	21.9	22.5	21.6	20.3	34.8	23.2
1975	16.3	23.2	20.7	20.6	20.8	19.6	32.2	24.2
1976	16.4	23.3	20.6	20.1	19.2	18.9	31.0	23.5
1977	17.4	22.2	20.8	19.7	20.9	18.3	30.1	23.0
1978	18.1	21.4	21.5	18.8	21.2	18.0	30.2	22.6
1979	17.9	p21.3	22.7	18.7	21.7	17.7	31.6	22.9

Source: US Department of Commerce, International Trade Administration, International Economic Indicators, June 1979 and June 1980.

Capital-labor ratios provide a basis for judging the economic impact of changes in the rate of capital formation. Capital-labor ratios measure the amount of productive capital per worker. Since capital is more efficient than labor, greater capital inputs per worker, increase output and productivity.

The studies that Christainsen and Haveman examined suggested that falling capital-labor ratios were responsible for approximately 20 percent of the overall productivity downturn.10

Precise changes in the capital-labor ratios are documented in table 10 below. Between 1950-65, capital-labor ratios increased at an annual average rate of 2.6 percent. Between 1965-73 increases averaged 3.1 percent per annum but between 1973-79 they fell to 0.6 percent.11

Table 10

Trends and Projections of Capital-Labor Ratio

Actual	Capital-Labor Ratio
1950-65	2.6
1965-73	3.1
1973-79	0.6
Projected	
1980-85	1.0-1.5
1985-90	2.0-2.4
1980-90	1.5-2.0

Source: Bureau of Labor Statistics

Two often cited causes of the decline in capital-labor ratios are an increase in the total number of workers and business response to rising energy prices.

Actual employment increased 2.0 percent a year from 1973 to 1978 as against 1.5 percent in 1948-73.12 Just to maintain constant capital-labor ratios, investment must grow at least as rapidly as labor increases. If it does not capital-labor ratios will fall.13

Higher fuel bills raise the operating price of capital. Labor costs become relatively less expensive than capital, encouraging a substitution of labor for capital. As less energy intensive technology becomes available, this phenomenon is likely to be reversed.

Some analysts suggest that capital-labor ratios are overemphasized. They believe that the role of innovation introduced primarily through new capital input and capital utilization levels should receive more careful consideration.14 If capital is available but underutilized then capital-labor ratios are meaningless.

Even more important is the possibility that increasing levels of investment might not have the dramatic impact on productivitiy that is often assumed.

Denison states:

> It is quite wrong to blame investment for recent sharp reduction in the growth of American output and productivity or to suppose that merely raising investment would go far toward restoring the old growth rate of productivity.

He adds:

> There is no substance to the recurring notion that the United States growth rate would have matched those of countries like Germany or Japan if only we invested as much as they did.

To attain average Japanese growth rates through increased capital investment, Denison shows that U.S. net investment would have had to have been raised 50 percentage points to 60 percent of national income.15

Denison does not deny the importance of capital formation as one factor in determining productivity growth, but he cautions that growth comes from a number of sources, of which capital is but one.

4. Declining Innovation and Research & Development Expenditures

When embodied in new technology, innovations increase output per unit of input or permit the same amount of measured output to be obtained with fewer inputs. Some leading productivity specialists agree that during most of this century and until the mid-1960's, the major source of productivity increase was research and development derived technololgical innovation.

As Nestor Terleckyj wrote:

> The pervasive appearance of significant correlations between R&D expenditures and productivity growth in studies using different data for different periods and different units(and established within different conceptual frameworks) strongly supports the conclusion that a positive relationship exists and that productivity increases can be induced by means of R&D based technological innovations. 16

Denison suggests that over one-half of the productivity growth between 1948-1966 arose from research and development.

In recent years many analysts have blamed diminished emphasis on research and development as an important factor in causing the productivity downturn. The statistical basis to support this contention comes from examining the stock of research and development and the percentage of GNP devoted to research and development.

According to Nadiri the stock has fallen 2.5-3.0 percent in recent years contributing about one-fourth to one-third of the productivity slowdown.17 According to the 1980 Council of Economic Advisers Report to the President, the real volume of resources devoted to research and development fell by 7 percent between 1968-1975.18

Others focus on research and development expenditures, specifically the percentage of GNP spent on research and development. As a percentage of GNP, total research and development spending has declined from almost 3.0 percent in the mid-1960's to 2.2 percent in 1979. See Table 11. The basic assumption is that declining investment in research and development slows the development of productivity improving innovations. Kendrick believes that diminished expenditures on research and development caused 30 percent of the decrease in productivity.19

Table 11

R & D Spending as a Percentage of GNP

Year	Percent R&D Total	Percent R&D Federally Funded	Percent R&D Industry Funded
1960	2.67	1.72	0.89
1965	2.91	1.89	0.94
1970	2.64	1.50	1.06
1971	2.50	1.40	1.02
1972	2.42	1.35	0.98
1973	2.32	1.26	0.99
1974	2.29	1.20	1.01
1975	2.31	1.19	1.12
1976	2.29	1.17	1.12
1977	2.26	1.15	1.11
1978	2.27	1.13	1.14
1979 (1)	2.29	1.13	1.16
1980 (2)	2.30	1.12	1.18

(1)Figures for 1979 are preliminary.
(2)Figures for 1980 are October,1980 estimates
Source: National Science Foundation

If the rate of technological innovation is determined by research and development expenditures then some of our major competitors are gaining a significant advantage. U.S. expenditures on research and development surpass those of our major competitors, but as a percentage of GNP theirs tend to be rising, albeit slowly, while ours have been stagnating. See Table 12.

Table 12
R & D Expenditures as a Percentage of GNP

Year	United States	France	West Germany	Japan	United Kingdom	USSR
1967	2.91	2.13	1.97	1.53	2.33	2.91
1968	2.83	2.08	1.97	1.61	2.29	NA
1969	2.74	1.94	2.05	1.65	2.23	3.03
1970	2.64	1.91	2.18	1.79	NA	3.23
1971	2.50	1.90	2.38	1.84	NA	3.29
1972	2.43	1.86	2.33	1.85	2.06	3.58
1973	2.34	1.77	2.22	1.89	NA	3.66
1974	2.32	1.81	2.26	1.95	NA	3.64
1975	2.31	1.82	2.39	1.94	2.05	3.69
1976	2.29	1.78	2.28	1.93	NA	3.55
1977	2.26	1.79	2.26	1.92	NA	3.47
1978	2.27	NA	2.28	1.93	NA	NA

Source: National Patterns of Science and Technology Resources: 1980
National Science Foundation, Washington, D.C. 1980.

There are some who voice concern with the superficiality of the above argument. They believe that a more important determinant of productivity than expenditure levels are the expected outcome of research and development and who performs it. Others complain that research and development expenditures fail to include the rate of innovation and diffusion which are as crucial if not more so than expenditures.

Econometric research indicates positive returns to privately financed research and development and weak or no returns to publicly financed research and development. As Terleckyj notes much clearer and more direct relationships have been found between private research and development expenditure and productivity growth than for government financed research and development.[20]

While federally funded research and development has fallen in the U.S., industry funding has increased slowly and steadily throughout the 1970's. See Tables 11 and 13.

Table 13
Federal R&D Obligations by Function
(in millions of current dollars)

Function	1969	1971	1974	1976	1979
Total Obligated	15,641	15,545	17,415	12.724	27,972
National Defense	8,356	8,110	9,016	10,430	13,833
share of total	(.53)	(.52)	(.52)	(.50)	(.49)
Space Exploration	3,732	2,893	2,478	2,863	3,383
	(.24)	(.19)	(.14)	(.14)	(.12)
All Civilian R&D	3,554	4,542	5,920	7,430	10,756
	(.23)	(.29)	(.34)	(.36)	(.38)

Source: U.S. National Science Board, Science Indicators 1978, Washington, D.C. 1979 Appendix Table 2-16.

Zvi Griliches retorts that it is not that publicly financed research and development offers no returns, rather those returns which do occur go unmeasured. He states:

> Since much of the overall R&D is spent on defense and space exploration, on health and environment, and on goods and services where quality improvements brought about by such expenditures are not captured in our national accounts, the slowdown in R&D that could have had a measureable impact was not as large as the crude figures might indicate.21

In 1973, he estimated that only about half of total R&D as measured is likely to affect measured productivity.

Denison questions if the whole analytical basis of measuring the contribution of research and development to productivity growth is not in error. He queries:

> just because the size of the economy is say, twice as big, does it take twice as much R & D to obtain the same annual productivity gain. Doubtless it would take twice as much R & D if an economy doubled its size by producing twice as many products each with a unique technology and no more of any one product. But why should more R & D be needed if growth occurs by expanding the average output of products rather than their numbers? 22

Although Denison concluded that in recent years the overall decrease in research and development expenditures is not a major source of productivity growth retardation:

> that is not to deny that expansion of R & D is a promising way of promoting future productive growth. Available studies indicate that the social rate of return on R & D is high. This, when combined with the inability of firms financing successful R & D to capture more than a fraction of that return for themselves, provides justification for policies either to raise that fraction or to increase governmental support.23

5. The Regulatory Environment

Government regulation encompasses a vast array of environmental, occupational health and safety rules and restrictions. Until 1973, it was assumed that their impact on productivity was minimal and thus not measured.

Following 1973, the situation changed dramatically. In the studies that Christainsen and Haveman examined, 14 percent of the productivity downfall was attributed to regulations.

The burden of environmental and safety regulations fall most heavily in mining, primary metals and on utilities. Regulatory critics claim that it is more than coincidental that these sectors are disproportionately responsible for much of the overall decrease in U.S. productivity growth.24

The regulatory impact on productivity is twofold:

First, critics of regulation claim that formation and enforcement is so unpredictable that corporate planning for research and development is impeded. The business community complains that new or unexpected regulations or revision can occur at any time. Regulations which might affect the ultimate result of research and development already in progress can be enacted at any time and without warning. As George Eads stated in a presentation before a meeting of the American Economic Association:

> A corporate decision maker, aware of recent history and knowledgeable of the present somewhat confused state of regulation, must consider the real possiblity that, if he proceeds to authorize steps leading to commercialization, somewhere down the road a new and currently undreamed of hazard will be identified that will lead to severe restrictions being placed on the marketability of his product. This may represent the greatest hurdle of all to new product development. For as expensive as the early stages of the product development process undoubtedly are, the real costs of bringing a new product to the marketplace only appear once the decision is made to move it out of the lab.25

By increasing uncertainty and risk, corporate planners are encouraged to make decisions that insure rapid but non-productivity improving payoffs.

Second, in addition to being a source of uncertainty for corporate planners, there are major costs involved in complying with regulations. Investment is diverted from areas likely to increase productivity to those designed to meet regulations which may have no productivity improving impact.

While measurement of regulatory costs are difficult, one study conducted in 1977 for the Joint Economic Committee (JEC) which probably overestimated acutal costs, claimed that compliance costs $100 billion annually.

A 1977 Business Roundtable study of 48 companies revealed that regulation costs these companies $2.6 billion annually, amounting to 10 percent of their capital expenditures, 16 percent of their net incomes after tax and 43 percent of their research and development expenditures. In testimony before the JEC it was suggested that investment in capital equipment for environmental goals account for about nine percent of investment outlays in the manufacturing sector.26 Rutledge, Dreiling, and Dunlop in a June 1978 *Survey of Current Business* article attributed 5 percent of total business outlays to pollution control related plant and equipment.

The redeeming values of regulations in the form of improved health, longer lives and a better environment must not be overlooked. While benefits are more difficult to quantify than the costs, they do exist.

A Data Resource study in 1979 suggested that environmental regulations can simultaneously lower productivity in some areas while raising it in others.27

Christainsen and Haveman note that:

> were the standard productivity measures effective indicators of welfare, these outputs would be included in the numerator of the measures. The few benefit cost analyses which have been made suggest the effect of these regulations on "true" productivity would be positive and not negative.28

There are some economists who assert that it might be improper to criticize regulation for reducing "long-term and basic research" and for "diverting investment in technology to modification of known techniques and products." While regulation might very well encourage this type of behavior there is little empirical evidence that "shorter term and applied research and modifications of processes and products" are any less socially benefical than other forms of R&D.29

Finally, expenditures on research and development to develop technology to comply with regulations may contribute to future productivity growth by creating new, competitive industry. Moreover, current efforts to improve the environment will limit damage and alleviate the need for more costly expenditures in the future.

6. Intersectoral Employment and Productivity Shifts

Two major structural shifts have altered the shape of the U.S. economy during the past 80 years. Both shifts are often credited with having an important impact on productivity growth.

The first shift occurred from the 1920's to the 1960's when a substantial portion of low productivity farm labor switched to employment in the higher output per hour non-farm sectors. Overall productivity growth rose in response, but this was a one time source of productivty increase which cannot be recaptured or repeated.

The second labor shift is currently underway. It involves slow steady movement from the manufacturing sector to the service sector. In 1970, 26.4 percent of employed labor was in manufacturing. By 1977, only 22.8 percent was. In 1970, 62.3 percent of the employed labor worked in the services. By 1977, that figure had risen to 66.5 percent.30

Controversy surrounds the importance of the shift to the service sector in undermining U.S. productivity. One-half of the studies that Christainsen and Haveman identified attributed a negative percentage to this shift. Service sector productivity is generally believed to be low. Concern has been voiced by some that devotion of an ever-growing proportion of the total economy to the services will become a persistent and increasingly frustrating drag on productivity growth.

Denison and Mark, reject the above contention.31 They point out that productivity growth rates vary dramatically within the services. Low or declining growth is true of only some of the services. Some like communications are among the economy's most rapid productivity gainers. Moreover, a quick look at Table 7 will show that overall service sector performance resembles overall productivity growth. It is no better and no worse. Both Mark and Denison claim that the impact and percentage shift to the service sectors has often been overstated. Even if a dramatic shift to the services occurs, Denison is confident that those services whose productivity growth is above average will be attractive and hiring.

7. Changes in Labor Composition

Labor quality is normally thought to depend upon the labor force composition and the worker's educational background.

The composition of the labor force has changed substantially in two ways. First, there has been an influx of relatively inexperienced youth and women. Together they have swelled the employment ranks and reduced the percentage of what are normally considered to be the most productive workers (prime age males between the ages of 25-54) from 46 percent of the work force in 1964 to 34 percent in 1978.

Table 14 demonstrates a high average annual percentage increase of both young men and women between 1965-1979. Five of the six studies that Christainsen and Haveman examined suggested that the infusion of less productive workers contributed to the productivity slowdown.

But by the mid-1980's, once the recent entrants gain adequate experience the age sex mix caused slowdown will be reversed. As Table 14 suggests the average increase in the number of new entrants, especially young men will slow significantly in the 1980s.

Table 14

Average Annual Percent Change in Civilian Labor Force

	Total	Men Under 25	Women
Actual			
1950-1965	1.2	1.4	2.4
1965-1973	2.0	4.8	3.5
1973-1979	2.4	2.7	3.9
Projected			
1977-1985	1.9	0.4	2.8
1985-90	1.1	1.7	1.7

Source: Bureau of Labor Statistics

The second important determinant of labor quality is educational background. A correlation is believed to exist between levels of education received and productivity growth. Kendrick and Denison attribute 13 percent of productivity growth since 1973 to a more educated work force.32 The percentage of the work force receiving at least one year of college education has grown rather rapidly and at increasing rates throughout the 1960's and 1970's. In the 1980's however, the percentage of highly educated workers will diminish. Thus, education as a source of productivity increase will also fall. See Table 15

Table 15

Persons with 1 or More Years of College

Average Annual Percent Change in Civilian Labor Force

Actual	
1950-1965	3.7
1965-1973	5.4
1973-1979	6.2
Projected	
1980-1990	2.6

8. Other Factors

In some ways this is the most important category for it includes the largely inexplicable portion of the productivity decline. This is a category that appears in four of the studies that Christainsen and Haveman studied. Those studies categorized from 16 to 67 percent of the decline as undefinable.

As Jorgensen and Grilliches wrote after trying to explain all output changes by increased factor inputs, "It is probably impossible to achieve our original program of accounting for all sources of growth within the current convention of national income accounting." 33

Denison discusses seventeen possible sources of decline which often go unmeasured and which he lumps in a residual category. Unfortunately, he dismisses most as unlikely explanations. They include:

-Decline in opportunity for major new advances;
-Decline of Yankee ingenuity and deterioration of technology;
-Increased lag in the application of knowledge due to aging capital;
-Government imposed paperwork;
-Regulations and taxation-diversion of executive attention;
-Regulation and taxation and misallocation of resources;
-Effects of high taxes on incentives and efficiency;
-Capital gains provision of the Revenue Act of 1969;
-People don't want to work anymore;
-Impairment of efficiency by inflation;
-Lessening of competitive pressure and changes in the quality of managment;
-Rise in energy prices;
-The shift to services and other structural changes; and
-Possible errors in data.34

III. Summary of Percentage Contribution of Sources of Decline

A more thorough understanding of the components of productivity growth will assist policy makers in devising policy to arrest or to reverse the productivity slowdown.

This study identified eight principal sources of productivity growth and slowdown. Little time was spent upon apportioning in percentage terms the weight of the specific variables because inconsistencies and distortions are inevitable in such comparisons. However, it is worth brief consideration.

Haveman and Christainsen attempted to sum up the percentage causes of the downturn as follows:

> The changing demographic composition of the labor force and hours worked together with sectoral shifts seem to receive substantial weight in most estimates, accounting for between 20-30% of the observed slowdown. Not unrelated to this is the slowdown in the rate of capital investment, resulting in a declining capital labor ratio...Studies attribute about 20-30% of the slowdown to these factors. The third important factor appears to be cyclical. These factors together with weather and work stoppages account for another 20-30% of the productivity slowdown. Between 10-40% of the slowdown is to be allocated to the large number of other determinants, of which environmenal regulations are one. An upperbound estimate then would attribute 12-15% of the aggregate productivity slowdown in productivity growth to these regulations. 35

Even though as much as one-half of the causes of the slowdown in productivity remains unknown, those factors that have been identified should form the basis for immediately establishing a program of productivity revival.

IV. Difficulty and Cost of Revitalizing Productivity Growth

The rate of productivity growth reflects, measures, and responds to the health of a multitude of interrelated and underlying economic variables. The variables that determine the overall health of the economy are the same variables that determine the rate of productivity growth. If the underlying variables are strong, productivty will grow rapidly. If weak, productivity will grow more slowly. In general, productivity growth rates cannot run counter to the overall economic trends. For the most part, they are determined by; they are not determinants of the state of the economy.

This is not to say that the rate of productivity growth has no role in determining economic health-for it does. But productivity growth cannot single-handedly cause or cure some or even most of the economy's problems. What productivity growth or decline does is to reinforce already existing economic conditions and trends. On the one hand, a vigorous economy stimulates high rates of productivity growth. High productivity growth can intensify the speed of economic growth. On the other hand, when the variables that determine the productivity rate of growth are weak, productivity growth will be slow and unhealthy. That sluggishness will further depress the economic state.

The only way to revitalize productivity is to solve the underlying problems. Curing the underlying factors will cure the productivity slowdown.

Many of the current problems in the underlying variables are structural and societal. Those will be reversed only slowly. Some of the sources of current productivity decline will reverse themselves naturally and eventuallly contribute to positive growth. Others however, arise from political decisions. Politically based policies that impact negatively on the underlying determinants of productivity can and should be reversed or revised.

Congress and the Executive Branch are the principals responsible for initiating policy to ensure the recovery of the underlying variables and as a consequence of productivity growth. What are some of the key policy decisions political leaders can make and practices they should encourage to improve productivity growth? A series of possible measures include reduced consumption and a higher rate of capital investment; a willingness to shift from obsolete industries instead of propping them up with protectionist trade barriers; incentives for innovation; and responsible price wage demands by industry and labor.

None of these proposals are by themselves adequate. As Denison states regarding policies for improving productivity growth:

> "We shall not escape our predicament without a broad program that affects numerous output determinants and requires actions less pleasant than cutting taxes on investment, saving, or income from capital.

Realistic proposals for solving productivity problems unfortunately have two things in common. First, the lag time between implementation and acutal improvement may be very lengthy. Second, the cost of the policies are likely to be very high, to cause suffering and sacrifice and to be distributed unequally. It is up to the political leaders to weigh the costs against the benefits. While implementing the policies might be costly, the more important consideration is, what are the consequences of not implementing them?

As a final point, it is worth mentioning the role of productivity and international competitiveness. Even though major U.S. competitors are likely to face some turn down in their productivity growth as the U.S. has in recent years, it is unlikely that any policy will enable the U.S. to match the productivity growth rates of the major industrialized nations in the near future. In fact, a major U.S. commitment to pursue productivity increase and economic reform policies will be required to keep the gap from growing. Part of that commitment should include the recognition that we can learn a great deal from the other nations whose recent record of productivity increase has exceeded ours.

Final Questions for Consideration

-Should investment in particular sectors be encouraged, especially in those that seem likely to achieve high rates of productivity growth?

-Should investment in low productivity growth sectors be discouraged?

-Even though the above measures may be politically unfeasible now, will further declines in domestic productivity and faster productivity increases abroad necessitate taking such steps?

-Will the need for new sources of investment capital cause policy makers to shift capital out of welfare payments, defense, and foreign aid which currently divert large chunks of potential investment funds to more economically productive uses?

-How much can productivity determine and or contribute to a healthy economy and how much does it just respond to and reflect prevailing economic condtions?

-What possibilities exist for catching Japanese and European average annual rates of productivity growth? Should U.S. policy have as a goal attaining the rates of key competitors? If so, what would be the domestic costs and benefits of such a policy?

Footnotes

1 See *Total Factor Productivity Index*, Houston: American Productivity Center, 1980.

2 Gregory B. Christainsen and Robert H. Haveman, "The Determinants of the Decline in Measured Productivity: An Evaluation," (Paper presented at a joint session of the Society of Government Economists and the American Economic Association, Atlanta Georgia, December 28, 1979).

3 See Paul Bennett, "American Productivity Growth: Perspectives on the Slowdown" Federal Reserve Bank of New York *Quarterly Review*,(Autumn, 1979), p. 27.

4 See Edward F. Denison, *Accounting for Slower Growth*. Washington, D.C.: Brookings Institution, 1979 pp. 135-136.

5 Martin Feldstein, "Tax Rules and the Mismanagement of Monetary Policy," *The American Economic Review*, (May, 1980), pp 182-184.

6 Robert M. Coen and Bert G. Hickman, "Investment and Growth in an Econometric Model of the United States," *The American Economic Review*, (May, 1980), pp. 217-218

7 J.R. Norsworthy, Michael J. Harper, and Kent Kunze, "The Slowdown in Productivity Growth: Analysis of Some Contributing Factors," *Brookings Papers on Economic Activity*. Edited by Arthur M. Okun and George L. Perry, Vol. 2, (Washington, D.C.: The Brookings Institution, 1979), pp.411-412. Also see Ernst R. Berndt and David O. Wood, "Technology Prices and the Derived Demand for Energy," *Review of Economics and Statistics*, vol.57 (August, 1975), pp. 259-268, Edward A. Hudson and Dale W. Jorgenson, "Energy Prices and the U.S. Economy, 1972-1976" *Data Resources Review*, vol. 7 (September 1978), pp. 1.24-1.37 and James M. Griffin and Paul R. Gregory, "An Intercountry Translog Model of Energy Substitution Responses," *American Economic Review*, vol. 66, (December 1976),, pp. 845-857.

8 Even though economists disagree as to the role that capital labor ratios play in determining productivity growth a number of studies suggest an important role. M. Ishaq Nadiri in "Sectoral Productivity Slowdown " *The American Economic Review*, May, 1980, p. 351, reports that while Nordhaus, Perry, and Thurow found no effect of capital stock on productivity growth, both his and Peter Clark's work were consistent and showed an effect.

9 Norsworthy, Harper and Kunze, p. 421.

10 In Edward F. Denison "The Contribution of Capital to Economic Growth," The American Economic Review, May, 1980, p. 221 he suggests capital has been responsible for from one-seventh to three-thirteenths of the long-term growth of net output in the U.S.

11 See Nadiri, p.352, who attempts to quantify the slowdown of productivity caused by declining capital-labor ratios on a sector by sector basis.

12 Denison, The American Economic Review, p.223

13 According to the Bureau of Labor Statistics the increase in 1976 in civilian employment was 3.4 percent, 4.4 percent in 1977, 3.6 percent in 1978 and 2.1 percent in 1979.

14 One reason for the disparity in productvity growth rates is that in the aftermath of World War II, Europe and Japan replaced destroyed plant and equipment with new equipment embodying the latest innovations. The U.S. was not forced to adopt new equipment incorporating technological innovations.as were the Japanese and Europeans. The result was that the technologically superior plant and equipment spurred rapid average annual rates of productivity growth in Europe and Japan, while U.S. rates lagged.

The U.S. Japan Trade Council's Council Report (October 10, 1980) sourcing the MITI Economic White Paper, 1980 reports that Japanese equipment reached its lowest average age in the early 1970's at 6 and a half years. In the mid-1960's it was about 9 years. Plant and equipment in the U.S. has averaged 10-11 years. The plant and equipment age gap between the two countries is narrowing with Japanese now approaching an average age of 8 years compared to the U.S. whose plant and equipment now averages 9-10 years.

15 For a more in depth analysis of the basis for these estimates see Denison, American Economic Review p. 222

16 Nestor E. Terleckyj, "What do R&D Numbers Tell US About Technological Change?", American Economic Review,(May, 1980), p.56-57.

17 Nadiri, pp. 350-351.

18 The Council of Economic Advisers, The Annual Report of the Council of Economic Advisers, (Washington, D.C.: Government Printing Office, 1980), p. 87.

19 John W. Kendrick, "Productivity Trends and Recent Slowdown: Historical Perspective: Causal Factors and Policy Options," in Contemporary Economic Problems, ed. by William Fellner (Washington D.C.: American Enterprise Institute for Public Policy Research, 1979), p.33.

20 Terleckyj does include the caveat that this may be a data problem. It may simply be that there is a greater time lag between the time that federally funded R&D is carried out and the time that it is translated into productivity increasing technologies compared with private sector research and development which has specific commercial objectives.

21 Zvi Griliches, "R&D and the Productivity Slowdown," The American Economic Review, (May, 1980), p.344

22 Denison, Accounting for Slower Growth, p. 6

23 Ibid, p. 7-8.

24 Council on Wage and Price Stability, Productivity, (A report submited to the Congress, July 23, 1979), p.12.

25 George C. Eads, "Regulation and Technical Change: Some Largely Unexplored Influences," The American Economic Review, (May, 1980), p.52.

26 US Congress, Joint Economic Committee, Special Study on Economic Change, Part II hearing before the Joint Economic Commmittee, 95th Congress, June 8, 19, 13, 1978 (Washington, D.C.: Government Printing Office, 1978), p.646.

27 Christainsen and Haveman, p. 23.

28 See A. Freeman, The Benefit of Environmental Improvement, (Baltimore, Johns Hopkins University Press, 1979) and L. Lave and E. Seskin, Air Pollution and Human Health (Baltimore, Johns Hopkins Univesrity Press, 1977).

29 Rolf Piekarz, "Discussion" of Innovation and Technological Progress, The American Economic Review, (May, 1980), p. 9

30 Mark Perlman, "One Man's Baedeker to Productivity Growth Discussions," in Contemporary Economic Problems, ed. by William Fellner (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1979), p. 81.

The Liberalization of Japan's Foreign Trade and Foreign Exchange Transactions

by

Hiroya Ichikawa

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The Japan-United States Economic Relations Group

I. Short History of Japan's Trade Liberalization

Reconstruction Period

When Japan resumed control of its foreign trade and capital transactions in 1950, there were considerable restrictions on trade and foreign exchange. This was largely because the limited amounts of Japan's foreign earnings had to be used effectively for the purpose of reconstructing the totally devastated economy. Since the demands for foreign exchange were so much more than the level of export earnings, Japanese Government had to allocate foreign exchange to those who had to import materials absolutely necessary for the reconstruction of the Japanese industry. In those days, the Japanese Government adopted the foreign exchange budget system (GAIKA YOSAN SEIDO) in order to directly control trade and foreign exchange and give priority to the purchase of "essential materials" from abroad. These trade and foreign exchange controls were similar to those adopted by many western European governments immediately after World War II.

During the 1950s, there were some small steps toward trade liberalization in Japan. For instance, in August 1950, the automatic import approval system (JIDO-SHONIN SEIDO) was introduced within the Foreign Exchange Budget System, and in 1959, the automatic import quota allocation system (JIDO-WARIATE SEIDO) was also introduced. These steps signified the very beginning of the liberalization of trade of Japan. However, Japan's trade liberalization was slow because high economic growth created excess demand for imports, resulting in chronic deficits in balance of payments. Furthermore, weakness of Japanese industries compared with those in advanced nations consituted a strong argument against drastic relaxation of import trade. By 1960, ratio of trade liberalization (measured by $\frac{(AA + AFA)}{\text{Total Imports}}$)[1] remained at a level of 41 percent.

Program for Trade Liberalization

In early part of the 1960s, there was high investment in modern plant and equipment, and Japan's international competitiveness gradually improved. Japan's trade volume expanded and foreign reserves began to accumulate. Against this background, the Japanese Cabinet approved the "General Principles on Foreign Trade and Foreign Exchange Liberalization" in June 1960, and a time schedule for comprehensive trade liberalization was announced. According to the program, the trade liberalization ratio was expected to increase from 40 percent to 80 percent in three years. In September 1961, the Japanese Government formally approved a program for the "liberalization of trade and foreign exchange which the government declared would accelerate the trade liberalization program so that the 90 percent level would be attained by September 1962. In fact, by 1964 trade liberalization ratio reached 93 percent, thus achieving a degree of trade liberalization similar to Western Europe. Import liberalization in passenger cars in October 1965 was a symbolic step to indicate Japan's keen interest in trade liberalization. Before this time, the importation of passenger cars was controlled by import-allotment regulations.

[What did the measures consist of? Tariff reductions? Lifting of quota restrictions?]

In addition to these measures, there was a dramatic improvement in Japan's importation system in April 1962. Prior to that period, imports into Japan were permitted only for items on a "positive list." But this positive list system was changed to allow all imports except for goods on a "negative list," which still required government approval. In April 1964 when Japan became an IMF Article 8 country,[2] the Japanese Government made it clear that there would be no foreign exchange restrictions on current transactions. As a result, the allocation system through the foreign exchange budget system was abolished. However, the import quotas was maintained for non-liberalized trade items.

The Japanese Government implemented trade liberalization program according to its own plan. This sharply contrasted with many countries in the West when they were forced to formulate trade liberalization schedule according to either bilateral or multilateral consultations in GATT as they became GATT Article 11 countries.[3] The Japanese approach was in a sense more effective in that its trade liberalization program was implemented in accord with domestic programs for the rationalization of Japanese industries and the degree of their international competitiveness. Secondly, Japanese trade liberalization was implemented on a non-discriminatory basis while the trade liberalization programs of many Western European countries discriminated among regions such as communist countries, dollar currency areas, and Japan. Indeed, some West European countries are still maintaining a considerable number of discriminating import restriction items directed against Japan. In sharp contrast, the Japanese liberalization was implemented on the basis of negative list system which does not discriminate any particular country.

Trade Liberalization and Japanese Concerns

In liberalizing import trade, there were major concerns in Japan regarding the impact on the balance of payments and on domestic industries. It was often argued that the rapid import liberalization in the 1960s would lead to abrupt import increases, thus resulting in a serious balance of payment difficulties and threatening domestic industries. It was argued that only strong industries would be able to survive the trade liberalization and Japan's growth potential on the whole would be seriously damaged.

On the eve of trade liberalization, there were a number of light industries in Japan which lacked international competitiveness. It was often pointed out that mining, agriculture, forestry, and fishery lacked competitiveness as well. In the area of heavy industries, in terms of the size of enterprises and technological level of equipment and processes, Japan was considered to be far behind those in many advanced nations. It was feared, therefore, that the trade liberalization would adversely affect the development of Japanese industries and an increase in number of declining industries leading to social unrest.

Quite contrary to this pessimistic outlook, the Japanese economy enjoyed high economic growth from the 1960s through the early part of the 1970s. During this period there was a remarkable shift in the Japanese industrial structure as well as its export structure away from light industries and toward heavy industries and chemicals. Japan also achieved enormous success in exporting and began to enjoy chronical balance of payments surpluses. In light of these surpluses, the balance of payment argument against liberalization was substantially weakened.

The change in export structure and industrial structure was successfully accomplished without causing any serious social problems. Most of the Japanese industries adjusted to trade liberalization very smoothly except coal industry which suffered considerably after the liberalization of petroleum.

In retrospect, the following factors seemed to be responsible for this successful transformation. First of all, there had been much new investment in plant and equipment, and modern technologies were introduced from abroad, leading to remarkable productivity gains. Although rapid wage increases in labor-intensive industries during a period of high economic growth were not offset by productivity gains, high economic growth made it possible for labor to move from low productivity sectors to higher and more efficient sectors. In fact, there was an acute demand for labor largely due to high economic growth, and there was no serious unemployment problems.

The Japanese Government worked out a very cautious schedule for opening up its imports according to the magnitude of the adverse impacts which trade liberalization was expected to have on domestic industries. Machine tools, electronic computers and other machinery were exempted from early trade liberalization as were agriculture and certain minerals.

Recent Developments in Import Liberalization

As already observed, Japan's import liberalization was steadily implemented during the late 1960s. The decontrol of the importation of automotive parts in October 1970 nearly completed import liberalization of most of important items. Liberalization ratio was a little over 93%, and a number of residual import restrictions had been reduced to 122 items from 493 in April 1962 when the "negative list" was initiated.

Those remaining items were thought to be difficult for further liberalization at that time. About the same time, both OECD and GATT suggested to member countries that residual import restrictions be eliminated. Most of items under import quota were agricultural items as well as products of small and medium sized companies; many industries believed they would be harmed by further import trade liberalization. As the U.S. balance of payment situation deteriorated in 1968, the U.S. formulated a dollar defense program and there were stronger demands in Washington that Japan eliminate residual import restrictions. At the December 1968 Cabinet meeting, the Japanese Government decided to further liberalize trade in light of Japan's international responsibilities for maintaining an open world trade system. By October 1971, a number of restrictions were drastically reduced to 40 items. Electronic computers and related equipments were liberalized in December 1975. With these liberalization steps, as far as mining and manufacturing trades are concerned, Japan has now only 5 items under residual import restrictions. On agricultural products, there are 22 items which are still subject to import restrictions.

As Table 1 illustrates, the U.S. maintains 7 residual import restrictions, Canada 5, France 46, West Germany 14, and Italy 8. Considering the very fact that some European countries still maintain discriminatory import restrictions directed against Japan, on the basis of quota restrictions, Japanese market compares favorably with those in other major industrialized nations.

Table 1

Number of Residual Import Restrictions in Major Countries

(as of Feburary 1979)

	Number of import restrictions	Agricultural products	Industrial products	Discriminatory import restriction against Japan
U.S.	7	1	6	--
Canada	5	4	1	--
U.K.	3	1	2	--
France	46	19	27	27
West Germany	14	3	11	3
Italy	8	3	5	33
Benelux	74	4	3	9
Japan	27	22	5	--

Tariff Reductions and GATT Negotiations

In addition to decontrolling residual import restrictions, Japan has gradually reduced the level of its tariffs. Japan reduced its tariff on 2,147 items during the Kennedy Round which was concluded in 1967. In 1972 Japan unilaterally reduced tariffs of almost all items by 20 percent. In 1978 Japan made other unilateraal tariff reductions. As a result of the cuts and Tokyo Round commitments now being phased in, Japan's average tariff rates are the lowest among all major industrial goods in the MTN reached nearly 50% as opposed to 30% for the U.S. and 25% for the EC. Thus Japan's reduction of tariffs was the biggest among all the countries participating in the MTN.

When the Tokyo Round tariff reductions are completed, Japan's average tariff rate (on a trade-weighted basis) will be about 3% compared with about 4% for the U.S. average tariff rate and 5% for the EC on manufactured products.

Moreover, the Japanese Government has publicly announced its intention to carry out advanced implementation of tariff reductions agreed to in the Tokyo Round.

In addition to tariff reductions on industrial goods, Japan offered tariff reductions with respect to some 200 agricultural, forestry, and fishery items. While the margins of the tariff cuts vary depending on items, they range between 30% and 50%.

Using applied or effective duty rates rather than GATT-bound rates as the base, Japan's tariff concessions on industrial products averaged 20% or so on a trade-weighted basis. This reduction will lower the average level of Japan's industrial duties to 3 percent on a global basis at the end of the phase-in period and to 3.1 percent on items of interest to the United States. But regardless of whether GATT-bound or applied duty rates are used as the basis of calculation, Japan's average tariff level on industrial products, which was comparable to the U.S. level at the beginning of the Tokyo Round, will be lower than that of the United States by the end of 1987.

The difference between the overall depth of Japan's industrial tariff concessions on a GATT-bound basis and on an applied basis reflects two unilateral reductions in Japan's tariff schedule since the end of the Kennedy Round. The first was a 20 percent across-the-board cut on four-fifths of all duties in November 1972. The second was made in March 1978, when the government further lowered the applied duties

Table 2

Tariff Rates and Reductions of Industrial Goods at the Tokyo Round

		Japan	U.S.	E.C.
Dutiable industrial goods only	Average basic rate (basic rate)	9.9%	8.2%	9.7%
	Effective rate of duty	6.9%	8.2%	9.7%
	Duty after reduction	approx. 5.5%	approx. 6.0%	approx. 7.0%
All the items including duty free items	Average basic rate (basic rate)	5.8%	6.0%	6.4%
	Effective rate of duty	3.7%	6.0%	6.4%
	Duty after reduction	approx. 3.0%	approx. 4.0%	approx. 5.0%

on 53 tariff schedule items (based on the four-digit BTN classification system) in anticipation that these reductions would be included as part of Japan's concessions in the Tokyo Round.

Among the industrial products on which tariffs were reduced in March 1978 were a number of special interest to the United States. These included cars (6.4 percent to zero), computer main frames (13.5 to 10.5 percent), peripheral equipment (22.5 to 17.5 percent), integrated circuits (15 to 12 percent), and color film rolls (16 to 11 percent). The duties on these and most other industrial products will be even lower at the end of the eight-year phase-in period for Tokyo Round duty cuts. For example, the tariff on computer main frames will fall to 4.9 percent and that on peripheral equipment will become 6 percent; the duty on integrated circuits will decrease to 4.2 percent, and the tariff on color film in rolls will drop to 4 percent.

Japan also agreed during the Tokyo Round negotiations to reduce its duties and/or bind the current tariff rates on nearly 225 agricultural, forestry, and fishery products (based on the seven-digit BTN classification system). Concessions on commodities of particular export interest to the United States were worked out during the intensive bilateral negotiations that ended in December 1978. These concessions included tariff cuts on raisins, grapes, canned peaches and fruit cocktail, grapefruit, almonds, walnuts, poultry, pork, vegetable oils, certain types of fish, lumber, and plywood, and a binding zero duty on soybeans.

The lower cost of U.S. exports to Japan resulting from the steep appreciation of the yen relative to the dollar has further diminished the import-inhibiting effects of Japanese tariffs. With the exception of a few remaining rather high duties, tariffs could not be considered a substantial barrier to U.S. exports to Japan before the Tokyo Round and will become an even less important factor as the MTN results are implemented over the eight-year phase-in period.

II. Non-Tariff Barriers Problems

At the Tokyo Round, there were successful negotiations on non-tariff barriers in addition to tariff negotiations. Japan accepted MTN codes and necessary revisions were already made with respect in domestic laws. The MTN agreement was ratified by the Japanese Diet on

April 23, 1980 and revisions of laws (such as changes in tariff rates as well as the industrial standards law) were approved by the Diet on March 31, 1980.

The discussion of NTB has often been clouded by the tendency of critics of Japan's trade policy to characterize all impediments to imports into Japan other than tariffs as "non-tariff barriers," without making a distinction between barriers that result from government practices intended to restrict imports and those that are a general feature of Japanese society and culture. This distinction is of special significance in the case of Japan, where American exporters' failure to adapt to the institutional habits of the Japanese have had a great deal more to do with the relatively poor U.S. export performance in Japan than the remaining tariff and non-tariff barriers.

The most important part of the work on non-tariff measures in the Tokyo Round concerned the negotiations of agreements on NTB issues considered appropriate for multilateral solutions. These were subsidies, technical barriers to trade, customs valuation, government procurement, and standards. For each of these, agreements were reached. Japan is a participant in these codes. As such, Japan is obligated to make some far reaching changes in its trade and trade related practices. Government procurement on the basis of public notice and lowest bids is entirely new to Japan.

TFC and TSG Activities

Many Japanese believe that Japan's remaining non-tariff barriers are neither as extensive or potent as seem commonly believed in the U.S., but allegations by U.S. exporters on this score persist. To handle specific cases and promote U.S. exports, the U.S.-Japan Trade Facilitation Committee was established in September 1977 by Secretary of Commerce Juanita Kreps and Japan's Minister of International Trade and Industry Toshio Komoto to identify "specific difficulties concerning Japanese trade practices or procedures encountered by U.S. companies in initiating or expanding their sales to the Japanese market." Much of the work of the TFC is carried out through liaison among American and Japanese government agencies and Embassy officers stationed in Tokyo and Washington. The TFC's Senior Review Committee meets several times a year to assess progress in the resolution of TFC cases and in joint trade development activities.

The principal activities of the TFC include the identification and elimination of impediments to U.S. exports to Japan resulting from Japanese trade practices and procedures, cooperation in export development activities, and analysis and identification of export opportunities for U.S. firms in the Japanese market.

The TFC has actively attempted to resolve cases concerning impediments to market access in Japan raised by U.S. companies and trade associations. As the following table shows, at least 15 cases have been resolved "favorably," some are still in the pipeline, and others have been dropped.

In addition to TFC, its unofficial, voluntary Trade Study Group (TSG) has served as an excellent forum to deal with the specific trade problems. TSG was established also in the fall of 1977 by Japanese and Americans from U.S. business community in Tokyo (ACCJ), the U.S. Embassy, Japan External Trade Organization (JETRO), Federation of Economic Organizations (KEIDANREN), Japan-U.S. Economic Council, Foreign Trade

Table 3

Joint United States-Japan Trade Facilitation Committee
Commerce TFC Steering Group:
Status of TFC Cases, July 1 - 31, 1980.

Total cases received to date	93
New cases received -- latest period	1
Cases dropped after Washington investigation	30
Total cases forwarded to Embassy, Tokyo	61
Cases in progress in Commerce	2
Cases forwarded to Tokyo	61
Cases forwarded -- latest period	1
Dropped after transmittal to Tokyo	23
Embassy obtaining additional information	8
Preliminary discussions held with appropriate Japanese Government agency	9
Forwarded to TFC	21
Cases forwarded to TFC	21
Cases forwarded -- latest period	0
Favorably resolved	15
Withdrawn -- not resolved	1
In progress	5
Bilateral consultations	5

Source: United States-Japan Trade Report, September 5, 1980. Subcommittee on Trade of the Committee on Ways and Means, U.S. House of Representatives

Table 4

Handling of Complaints Brought Before the TFC
(through November 1980)

Number of complaints taken up in the TFC	20
Number of complaints resolved	14
(1) Zirconium tubing	
(2) Potato chip tariff classification	
(3) Half-finished lubricating oil (levying of new petroleum tax)	
(4) Zirconium channels	
(5) Import quotas for recreational hang gliders	
(6) Airport lighting system	
(7) Medical equipment (approval procedure)	
(8) Emergency signaling device for handicapped people	
(9) Hydrofoils	
(10) Fish vaccine	
(11) Flashlight batteries	
(12) Spare tire H.P. canisters	
(13) Shock absorbes	
(14) Ammonium phosphate fertilizers	
Number of complaints now pending	6
(1) Case for which solution is at hand: Hepatitis test reagent	
(2) Cases which are yet to be solved:	
(i) Revision of rates for data communication dedicated lease lines, affecting MODEMS	
(ii) Revision of medical treatment charge computation formula for dialyzers	
(iii) Imports of cigaretts	
(iv) Regulations on animal vaccines	
(v) Line restrictions on time-sharing service operations	

Council of Japan, Japan Chamber of Commerce and Industry, and others from Japanese business and government communities, all acting in their individual capacities.

TSG has four standing committees covering generic matters, specific product matters, promotion, and communications.

Its functions have been to identify, analyze and make recommendations with respect to laws, regulations, procedures or practices in Japan which inhibit increased sales in Japan of U.S. goods and services, and to promote U.S. exports in Japan.

III. Foreign Exchange and Foreign Investment

A substantially amended Foreign Exchange and Foreign Trade Control Law came into effect as of December 1, 1980. Since the end of the war, Japan's exchange controls have been basically restrictive. The old exchange control legislation consisted of two major laws (The Foreign Exchange and Foreign Trade Control Law and the Foreign Investment Law, enacted in 1949 and 1950, respectively) and the related cabinet orders, the ministerial ordinance and circulars. When these laws were enacted about 30 years ago, a shortage of foreign exchange reserves and balance of payments difficulties were determinant factors in making Japan's exchange controls basically restrictive in nature. For reconstructing the Japanese economy at that time, effective use of the scarce foreign exchange reserves was considered to be vitally important. The exchange controls were used almost exclusively for accumulating foreign currency and preventing its outflow. The old Foreign Exchange and Foreign Trade Control Law was on the basis of the prohibition of foreign exchange, foreign trade and other external transactions.

However, in many instances those restrictive regulations were relaxed in the form of related cabinet orders, ministerial ordinances and circulars. The old Foreign Investment Law, which has been repealed and now subsumed in a substantially amended Foreign Exchange and Foreign Trade Control Law, placed the inflow of foreign capital and foreign technology into Japan under an approval system in principle.

As Japan began to accumulate foreign currency holdings since 1965, however, the exchange controls have been liberalized in tune with Japan's balance of payment position and the international environment.

In fact, the prohibitions and restrictions imposed by these laws have since been substantially liberalized through amendment of Cabinet Orders and Ministerial Ordinances for the Foreign Exchange Law and through the transier of approval procedures to the Bank of Japan as well as introduction of an automatic approval system for the Foreign Investment Law. As a result, the level of liberalization of Japan's foreign exchange control had already reached in its substance a stage which could be compared with that of many advanced nations.

As Japan's balance of payments surplus started accumulating very rapidly around the spring of 1977, the Japanese system of "prohibiting external transactions in principle and placing their relaxation solely at the discretion of the administrative organs" tended to invite unnecessary overseas criticism and misperceptions regarding Japan's external economic policy management. Many considered that Japan was not following an open economy policy.

In addition to such international criticism, there had also been criticism in Japan, arguing that Japan's foreign exchange control legislation was difficult to comprehend. The accumulation of the amendments of Cabinet Orders, and ministerial ordinances enacted up to then appeared to have made the situation worse. As a result, a thorough review of the entire structure of the law was urged with increasing frequency. Trading companies, for instance, requested the Japanese Government to revise its exchange controls in order to simplify export and import procedures. It was in such circumstances that then Prime Minister Fukuda made it public at a press interview in 1978 that the Japanese Government was willing to develop new foreign exchange control legislation on the principle of freedom of external transactions.

Subsequently, both the Japan-U.S.A. and Japan-EC economic negotiations produced joint-communiques (on January 13 and March 24, 1978 respectively) stating that the Japanese Government would carry out an overall review of the foreign exchange control system with a view to introducing a new system based on the principle of freedom in all external transactions, unless specifically obligated to acquire license or approval. Then, the Inner Cabinet meeting on Economic Policy Measures decided on March 25, 1978 to start working on the full-scale revision of the Foreign Exchange and Foreign Trade Control Law and the Law concerning Foreign Investment in order to present an amended bill to the coming ordinary session of the Diet.

A ful scale revision of the law had been attempted twice before. The first instance was in 1958/59 and the second one was in 1963/64 wherein a broad rearrangement of Ministerial Ordinances and

Notifications took place, but the stage of drafting a revised bill wa not reached.

Since the amendment was expected to substantially affect those engaging in external transactions as well as broad sectors of the Japanese economy, intensive efforts were made to hear views of the private sector including the financial and foreign trading communities as broadly as possible.

Furthermore, an "Advisory Committee on the Legal System of Foreign Exchange and Foreign Trade" was established as a private consultative organ to the Minister of Finance and the Minister of International Trade and Industry, with 20 members under the chairmanship of Mr. Shigeo Nagano, President of the Japan Chamber of Commerce and Industry.

The committee presented its report of proceedings on April 23, 1979. The committee's recommendations became the basis for the amendment.

Main Features of Amendment

Objective

The objective of the Law (Article 1) has been rewritten entirely, and clearly stipulates the principle of freedom of foreign exchange, foreign trade and other external transactions.

However, when such a principle is considered to have an adverse effect or cause friction both at home or abroad, certain regulatory measures are to be imposed. Such measures, the Article states, should be limited to "necessary but minimum control or adjustment." In the old law, objectives of those controls and adjustments were for "the most economical and beneficial use of foreign currency funds" and "the rehabilitation of the national economy." Such objectives have been deleted in the new law and the newly revised article states that the objectives of such control or adjustment are "to enable proper expansion of Japan's external transactions," and "to facilitate the equilibrium of balance of payments and the stability of Yen." In addition to Article 1, some articles of the revised Law stipulate as reasons for imposing restrictions on external transactions "the faithful adherence to treaties and other international agreements concluded by Japan, "international peace and security," and "the maintenance of public order."

Definition of Capital Transactions

Unlike current transactions, which assume a transfer of goods or services, a capital transaction can be defined as one whereunder only funds change hands, with no movement of either tangible goods or services. The old law included some current account transactions because a broader concept of "claimable rights" were adopted for defining a capital transaction. The old relevant Cabinet Orders and Ministerial Ordinances also placed capital transactions among "invisible transactions." These definitions often created difficulties in properly comprehending the regulations concerning capital transactions.

The amendment, in Article 20 defines capital transactions as follows:

(1) deposit and trust contracts

(2) money lending and borrowing contracts and guarantee contracts

(3) sales contracts of foreign means of payment and claimable rights (such rights as those resulting from money lending, exportation of goods, etc.)

(4) transactions between residents which are payable or receivable in a foreign currency such as (i) deposits and lending/borrowings in a foreign currency (ii) sales and purchase of foreign means of payment or claimable rights payable in a foreign currency, and (iii) sales and purchase of goods or claimable rights payable in Yen, both of which settlement is made in a foreign currency.

(5) the transfer, issuance and offering of securities. Offering of securities includes deals with non-residents issuance and offering abroad of securities dominated in Yen (the so-called Euro-Yen bonds)

(6) transactions involving immovable properties. These transactions have been placed under the jurisdiction of the Ministry of Finance, as one type of capital transaction because of their similarity to direct investments.

(7) the transfer of funds between main office, branches, and representative officers existing in Japan and in a foreign country of one and the same juridical person, other than those resulting from deposit, trust, or lending and borrowing transactions between those offices.

The main transactions under this category are the remittance of establishment expenses for such offices and the transfer of funds inside a company or a group of companies. In reality, the major part of such inter-office or inter-group transfers should be of current nature such as payment of commissions, etc. and lendings and borrowing. However, due to the specific nature of such transactions, it is possible that the transfer of funds takes place relatively easily and in a large sum. This is the reason why such transactions are covered by this item as being one type of capital transaction.

(8) In addition to above items, the new Law allows a Cabinet order to designate any other transactions as capital transactions.

(9) One type of transaction, concerning the inflow of foreign capital is defined as "direct domestic investments, etc." in this amendment, and therefore is excluded from the definition of capital transactions.

Restriction on Capital Transactions

The Japanese economy experienced large-scale inflows of speculative money at the time of the so-called "Nixon Shock in 1971," during the drastic deterioration of the balance of payments triggered by the oil-shock in the fall of 1973, and during the persistant upvaluation of the Yen exchange rate from the fall of 1977 throughout 1978.

Article 21 of the amendment stipulates that certain regulatory measures on capital transactions can be put into effect when there is rapid accumulation of surplus or widening in the deficit of Japan's balance of payments and when a drastic fructuation of Yen is foreseen.

Furthermore, in order to safeguard the effectiveness of domestic monetary policy manipulation againt "transfers of funds between Japan and foreign countries in a large volume," the Minister of Finance is to activate the licensing system for capital transactions. The actual proceedures will be studied in the course of the enactment of the relevant Cabinet orders and Ministerial Ordinance.

While the three instances given above may trigger the licensing system, what degree of such instances should actually activate the restrictions? And what are the criteria? While this question has been subject to hot debate in the Diet, the very nature of speculative money seems to have made it impractical for the Japanese government to declare such criteria in advance.

A newly established "Committee on Foreign Exchange and Other Transactions", which was transformed from the "Foreign Investment Council", is expected to study the regulating measures in general terms rather than in terms of concrete criteria for activiation.
At any rate, any abuse of such regulating measures should be avoided as the objectives of the Law (article 1) provides for. Except for the emergencies mentioned above, capital transactions divided into three categories:

i) free

ii) free so long as prior notice is submitted to the Minister concerned and no adverse effects are foreseen.

iii) restricted

Capital transactions on which prior notice is required are: Overseas lending, bond issuance in overseas markets or foreign currency bond issuance in Japan by residents, bond issuance in Japan by non-residents, direct overseas investment, and acquisitions of real estate in Japan by non-residents.

Changes or Disapproval of Capital Transactions

The government may order changes or disapprove capital transactions on which prior notice is given, when the said transactions:

(1) may have an adverse effect on international financial markets and cause Japan to lose her international creditability,

(2) may have an adverse effect on the domestic money and capital markets,

(3) may have an adverse effect on business activities in specific sectors of industry or the smooth management of the economy in Japan, or

(4) may hamper the performance of international treaties or agreements between Japan and other countries, endanger international peace and security or disturb public order.

The government must advise on the changes in the capital transactions, if any, or express disapproval within 20 days after receipt of prior notice. In the case that the government finds the transactions to have no adverse effects, no response is made. Therefore, the transactions may be executed after 20 days unless advice to the contrary is given.

Other Restrictions on Capital Transactions

Aside from the above, it is necessary to obtain a license from the Minister of Finance when those capital transactions mentioned below are not conducted by an authorized foreign exchange bank operating in Japan:

(a) Deposit or trust transactions;

(b) Sales and purchase of foreign means of payment or claimable rights;

(c) Foreign currency transactions between a resident and another resident.

And moreover, the issuance or offer for subscription of the so-called Euro-Yen bonds by a non-resident is subject to the license of Minister of Finance.

To be more specific, all the following require a license from the Minister of Finance: (1) when a resident places a deposit or establishes trust funds with a financial institution or other which is not operating in Japan (overseas branches of our authorized foreign exchange banks fall under the definition of financial institutions not operating in Japan), (2) sales and purchase of foreign means of payment or claimable rights, of which a party is not an authorized foreign exchange bank, such as made between non-banking business concerns or individuals, and (3) lendings of foreign currency between a resident and another resident, neither of them being an authorized foreign exchange bank.

In fact, when deposits are placed or trust funds are established outside of Japan, it becomes very difficult to trace the subsequent movement or appropriation of these funds. A loophole might ensue therefrom in regard to enforcement of regulations. (Needless to say, transactions of small amounts with no specific problem will be exempt from the regulations.)

Sales and purchase of foreign means of payment and claimable rights fall, in a broader sense, under foreign exchange business, and insofar as banks' dealings in foreign exchange business are placed under the authorization system (Article 10), it may be inevitable to impose control on those dealings conducted by parties other than foreign exchange banks. Furthermore, since this type of dealing constitutes a foreign exchange market itself, it is reasonable to insist that one party be an authorized foreign exchange bank.

As for lending in foreign currency within Japan, it was taken into consideration that they have long been carried out as a part of the business of the authorized foreign exchange banks, and any sudden change in this area may cause undesirable problems.

Needless to say, even though these transactions are conducted as business of the authorized foreign exchange banks and free from regulation at ordidnary times, they are still subject to the emergency regulatory measures imposable under Article 21, Paragraph 2 of the amendment.

Floatation of Euro-Yen bonds is an act performed abroad by a non-resident. International practice, however, has been well established to require approval of the sovereign country of the currency involved, and this is one of the considerations taken in placing it under the licensing system.

As for sales and purchase of foreign means of payment or claimable rights, even for those conducted as business of the authorized foreign exchange banks, a limitation is imposed as "only those which meet the conditions determined by the Minister of Finance." This limitation intends to provide for such requirements as the so-called principle of non-speculation, if necessary.

Direct Investment in Japan

Direct investment in Japan of foreign capital will be free if no adverse effects are foreseen and as long as prior notice is given.

In case that direct investment in Japan is found to be likely to:

A) endanger national security, national order or the safety of Japanese citizens; or

B) harm Japanese businesses in the same industry where investment is planned, or have serious adverse effects on the smooth management of Japan's economy,

the government will ask for the opinion of the Foreign Exchange Council, to be newly established, and is allowed to order changes in or to disapprove the investment. The government must advise on the changes or express disapproval within 30 days of the receipt of prior notice. But this period may be extended to four months in case the government finds it necessary for the Foreign Exchange Council to deliberate on the notified capital transactions and to five months (this is the maximum length of the extension) in case the Council is unable to complete deliberations within four months. Foreign investors may execute the transaction only after this period is over.

The control of transactions concerning inflow of foreign capital and technology which heretofore was exercised under the former Foreign Investment Law differs somewhat in nature from other provisions of the amendment.

The category of direct domestic investments, etc. employs a concept of "foreign investor" as a party involved, which differs from the concept of resident or non-resident. For direct domestic investments, etc., the administration's main concern rests upon how to discern and regulate the transaction's after-effects, such as how or to what extent the recipient business concern is controlled by foreign investors etc., rather than how to regulate the flow of funds crossing the border. Regarding this category of transactions, not only the Minister of Finance and the Minister of International Trade and

Industry, but also the "Minister of Finance and the Minister(s) in charge of the industry involved jointly" have jurisdiction.

At the time of its promulgation, the former Foreign Investment Law treated the repatriation of funds redeemed or fruits from investment (if certain procedures required by the Law have been satisfied) as having been approved by the Foreign Exchange Law, which is the so-called repatriation guarantee. This was in order to encourage inflow of sound foreign capital that helps ameliorate Japan's international payment position. This was a reflection of Japan's economic situation at that time. However, in the amendment the principle of the freedom of sending money abroad rescinded such special treatment.

Moreover, foreign investors' acquisition of "corporate debentures" (limited to those maturing more than one year after the acquisition) and "beneficiary certificates" of loan trust, had fallen under the jurisdiction of the former Foreign Investment Law, but the amendment includes them into ordinary capital transactions.

"Foreign Investors" are basically:

(i) (As to individuals) non-residents;

(ii) (As to juridical persons and other organizations) those established under foreign legislation (therefore branches in Japan of foreign juridical persons fall under this category, even of they are residents);

(iii) Juridical persons and other organizations considered to be controlled in substance[4] by those given in (i) or (ii) above.

Basically, these definitions remain unchanged from those given in the former Foreign Investment Law, except for the exclusion from the term "foreign investors" of alien natural person residents (in other words, those falling under the definition "one who has not Japanese nationality" mentioned in Article 2, Paragraph 1 of the "Cabinet Order concerning Acquisition of Properties and/or Rights by Foreign Nationals" (Cabinet Order No. 51 of 1949) are excluded from the term "foreign investors" and consequently, are no longer subject to restrictions concerning direct domestic investments.)

Definition of "Direct Domestic Investment" given in the amendment (Article 26) is basically as follows:

(i) Acquisition of stock or share of a company which is not a "listed Company." This means any acquisition of such stock or share falls under direct domestic investment, irrespective of the quantity or ratio of acquisition.

However, transfer among foreign investors of such stocks or shares already acquired by one of them is excluded from direct domestic investments. This is because such a change of ownership by no means alters the situation in regard to foreign investors' control over a given company. But, transfer of such stock or share which was acquired by the transferer while he was a resident, to a foreign investor after the transferer has become a non-resident (such as after his repatriation from Japan) falls under direct domestic investments, because such transfer is equivalent to new acquisition of such stocks or shares by a foreign investor. Also because these cases are likely to take place due to the fact that acquisition of any stock or share by an alien natural person resident is free from restrictions.

(ii) Stock of the "listed companies," are freely dealt with in an open market.[5] Only such acquisition by a foreign investor (including acquisition by other party(ies) under his control) in a quantity which equals or exceeds 10% of the total stock issue of a given listed company falls under direct domestic investment. (This percentage can be raised by a Cabinet Order.)

(iii) Concerning consent given to an alteration of the objective of a company's business, this designation purports to plug a loophole which might otherwise ensue from amending an existing company's business objective into one upon which regulations are imposed. However, since the Commercial Code requires consent of one-third or more of the stockholders for alteration of a company's articles of incorporation, the consent that falls under direct domestic investments is limited to one given by one-third or more stockholders.

(iv) Establishment of a branch, etc., in Japan (including alteration of the type or the business objective of a branch, etc., existing in Japan.

Heretofore, establishment of a branch, etc., in Japan, in spite of its similarity in substance to incorporation of a company in respect of business activities carried out by it, was not placed under the scope of regulations of the Foreign Investment Law (only a prior notice thereof was required by the former Foreign Exchange Law), and thus such imbalanced treatment has been rectified by this definition.

(v) Money lendings by a foreign investor to a juridical person in Japan the term of which exceeds one year. Lendings by banks and other financial institutions designated by Cabinet Orders are excluded. It is also made clear that lendings of small amounts are to be excluded.

Heretofore, lendings by financial institutions which fall under the definition "foreign investors," such as foreign banks' branches in Japan, were placed under the Foreign Investment Law. However, since such lendings are made as a business transaction and do not usually aim at subordinating the borrowers, the amendment excludes them from direct domestic investments. Consequently, those subject to restrictions are long-term (more than one year) lendings between non-banking concerns, etc. Lendings of this type generally suggest existence of certain special relationship between lenders and borrowers or an intention to create such a relationship, and therefore are treated as direct domestic investments. Further, any other act similar to those above may be designated by a Cabinet Order as falling under direct domestic investments.

Any foreign investor making any direct domestic investment, etc., is required to give prior notice to the Minister of Finance and the Minister(s) in charge of the industry involved. The foreign investor who has given such notice is not allowed to carry out the transaction until a period of 30 days has elapsed from the day of receipt of the notice by the Ministers. However, similar to the case of capital transactions, this period may be shortened, and most transactions would be allowed to be carried out before this 30 day period has elapsed.

When the transaction under notice is deemed to cause apprehensions as to the occurrence of any consequences mentioned below, or to result in such consequences, the above-mentioned period can be extended to 4 months (or 5 months when the transaction is especially difficult to scrutinize). Within this period, the transaction is scrutinized, and if found necessary, recommendation or a directive to either alter its particulars or suspend its execution is given. Unlike the case of capital transactions, such a recommendation is required to be given after hearing the opinions of the Committee on Foreign Exchange and Other Transactions. (Article 27)

Furthermore, a point deserving attention is that when a person other than a foreign investor is to acquire stock, etc., "on behalf of a foreign investor but not in the latter's name" (the so-called transaction through dummy, such as acquisition of stock throug trust banks in Japan), that person is deemed, considering the actual effect of the transaction, as a foreign investor. In the case of ordinary capital transactions, the legislation's concern is with the flow of funds crossing the border, irrespective of such matters as whether the operator is a dummy or not. However, since in the case of direct domestic investment, attempts to subordinate business enterprises require control, consideration of the substance of a transaction becomes necessary.

As prerequisites to the recommendation or directive mentioned above, Article 27, Paragraph 1 of the amendment enumerates the following conditions:

(1) If it might imperil the national security, disturb the maintenance of public order, or hamper the protection of the safety of the general public; or

(2) If it might adversely and seriously affect activities of Japanese business enterprises engaging in a line of business similar

or related to the one in which the direct domestic investment, etc., is to be made, or if it might affect the smooth performance of Japan's national economy;

(3) If it is made by a foreign investor with whose country no treaties or other international agreements are concluded by Japan in regard to direct domestic investment, etc., its particulars are required to be altered, or its execution is required to be suspended, so as to make conditions substantially equal to those allowed to Japanese national's investment activities (i.e., diret domestic investment, etc., mentioned in each Item of Paragraph 2 of the preceding Article) in that country; or

(4) If its objective is seen to fall under, in whole or in part, capital transactions upon which an obligation to obtain a license is imposed under the provisions of Article 21, Paragraph 2, its particulars are required to be altered, or its execution is required to be suspended.

Item (1) presupposes those industries of which liberalization is not required by the OECD's Code of liberalization of capital movements (such as weapon, explosives, nuclear power, special vaccines, etc.)

For Item (2), as to what types of industry will still be subject to the discussions, immediate candidates should be the still remaining non-liberalized four hardcore industries (agriculture and fisheries, mining, oil, leather and leather products manufacturing).

Item (3) aims at maintaining the principle of international reciporcity.

Item (4) intends to deal with attempts such as evading emergency restrictions imposed upon capital transactions under the guise of direct domestic investment. (For example, when restrictions are imposed upon domestic securities investments by foreign investors as a part of an over-all control of short-term capital inflow, any attempt to establish a company by direct domestic investment, let it acquire those securities of which acquisition by foreign investors is restricted, and immediately resolve the company for realization of capital gains.)

For conclusion of agreements for importation of technology between a resident and a non-resident, prior notice is required to be given to the Minister of Finance and the Minister(s) in charge of the industry involved. (Article 29)

When the Ministers deem that, if the conclusion under notice were executed, any of the below-mentioned consequence might ensue therefrom, they are entitled to take similar measures to those of direct domestic investments such as upon hearing the opinion of the Committee on Foreign Exchange and Other Transactions and within a specified period, they may give a recommendation to alter the particulars or to suspend the execution. If this recommendation is not heeded, they may serve a directive to alter the particulars or to suspend the execution.

(1) If it might imperil the national security, disturb the maintenance of public order, or hamper the protection of the safety of the general public; or

(2) If it might adversely and seriously affect activities of Japanese business enterprises engaging in a line of business similar or related to the one for which the technology is to be imported, or if it might affect the smooth performance of our national economy.

The current regulatory system of agreements for importation of technology requires either (i) authorization under the Foreign Investment Law for those of A type, whose life of agreement or period of settlement of proceeds exceeds one year, or (ii) license under the Foreign Exchange Law for those of B type, whose life or period is shorter. The amendment unifies these two categories, and also changes authorization or licensing of one requiring prior notice (which is subject to directive of alteration or suspension).

Measure against Foreign Takeovers

The problems of whether or how to regulate foreigners' large-scale open market acquisition of listed stock generated diverse arguments and opinions among both the Foreign Investment Council and the Advisory Committee. This debate finally concluded that time is still needed by those concerned to prepare themselves against complete abolishment of the existing regulations. Thus, transitional regulatory measures still remain in the form of amendments of Supplementary Provisions of the Law, in the following way:

"For the time being, when the Minister of Finance and the Minister(s) in charge of the industry involved deem it necessary to make an inquiry to determine whether apprehensions as to the occurrence of any of the below-mentioned consequences might ensue from the possession in excess of a certain quantity of certain companies' stock, etc. (which mean the stock of the listed companies, etc., mentioned in Article 26, Paragraph 2, Item (1), and other securities designated by a Cabinet Order, which shall apply hereinafter) by any non-resident natural person, and/or juridical person or other organization established under foreign legislation, and/or juridical person or other organization having its main office in a foreign country (hereinafter collectively referred to as "non-resident natural person, etc."). In this case the Ministers may designate, as a Cabinet Order provides for, certain companies which issue such stock, etc., as those subject to such an inquiry:

(1) If it might imperil the national security, disturb the maintenance of public order, or hamper the protection of the safety of the general public; or

(2) If it might adversely and seriously affect the smooth performance of our national economy.

The above-mentioned "stock in excess of a certain quantity" means an instance wherein aggregate number of stock of a certain company held by non-resident natural person(s), etc., equals or exceeds 25% (a Cabinet Order may raise this ratio) of that company's total stock issue.

When such designation is made, acquisition by "non-resident natural person, etc." of that designated company's stock requires a prior notice (unless the acquisition does not make the aggregate stockholding by non-resident natural person(s), etc., equal or exceed 25% of total stock issue of the company concerned). The party that has given such notice is not allowed to acquire the stock under notice within 30 days thereafter. The subsequent procedures are similar to those of direct domestic investments, etc., such as the extension of that period up to 4 months when the Ministers deem it necessary to scrutinize the particulars of the acquisition against the negative criteria as mentioned above, and so forth.

In this way, it is made possible to alter or suspend foreign stockholding of more than 25% of certain designated companies.

However, the former requirement of asking whether consent of the company concerned will be given or not, and multi-scale foreign stockholding ceilings (15% or 25%) according to lines of business of the companies concerned are both abolished.

Foreign Exchange Council

A Foreign Exchange Council will be set up, as an organization attached to the Minister of Finance, in order to deliberate on important matters on foreign exchange, direct investment in Japan and introduction of foreign technology, when an opinion is requested by the Minister of Finance, the Minister of International Trade and Industry, or other Ministers concerned.

The Council will consist of up to 15 members appointed by the Minister of Finance selected from men of knowledge and experience.

Concluding Remarks

As mentioned earlier, Japan's exchange control system consists of two major laws which have now been revised and combines into one, and the related cabinet orders, ministerial ordinances and circulars.

The revision of the law itself indicates only the basic direction for the legal system, and those orders and other administrative ordinances that will be applied to individual transactions and reviewed under the new law, have not yet been made public.

It is, therefore, difficult now to estimate exactly how far exchange controls have actually been liberalized until we see the whole control system revised, but it may be worth pointing out the following:

(i) This will be the first complete revision of the exchange controls since their enactment. It will be epochmaking in that the basic principle of the law is freedom instead of prohibition.

(ii) The revision will certainly be another major step in opening Japan's markets to foreigners.

(iii) Although the law specifies the areas left under control and provides for exceptions, these are necessary for coping with emergencies in order to maintain a stable foreign exchange market and to maintain sound development of the domestic money and capital markets. The government should establish clear guidelines for administrative intervention and try to limit restrictions based on the safeguard provisions to a minimum.

(iv) The revision of the law will effect not only a basic change in Japan's external transactions but also in domestic money and capital markets. It will facilitate further steps toward liberalization of interest rates and freer competition among financial institutions, desirable for a more efficient and internationally acceptable financial system.

(v) Such changes in the financial system will not be effective simply through the revision of exchange controls. It is essential at the same time to reform domestic financial practices and legislation among other things. In this sense, the revision of the exchange controls is an important first step for a more open Japan.

FOOTNOTES

1. AA (Automatic Approval System) is most liberalized system according to which permission to import is automatically granted at an authorized foreign exchange bank without MITI approval. AFA (Automatic Fund Allocation System) allows automatic allocation of foreign funds for import of foreign goods.

2. In Article 8 of IMF provisions, the following three are listed as the obligatory conditions of member countries.

   1) Abolition of restrictive practices and legislations of foreign exchange regarding the current trade account.

   2) Repeal of discriminatory monetary regulations.

   3) Establishment of exchangeability of reserves held in own currency by foreign countries.

   Countries observing these conditions are called Article 8 countries, and those countries which cannot do so due to balance of payments problems may be exempt from such obligations under IMF Article 14. These countries are obliged to consult the IMF authorities every year and attempt to liberalize foreign exchange controls at the earliest possible time. Japan became an Article 8 country in 1964.

3. In Article 11 of GATT provisions, it is prohibited to establish and/or maintain restrictive conditions such as quotas, permission systems, etc. except tariffs or taxes regarding the import or export of products in the following circumstances:

   1) When the exporting country tries to avoid critical shortages of important products such as food by the prohibition or control of export.

   2) When the government imposes import controls for important domestic reasons regarding products in agriculture and fishing.

4. "Considered to be controlled in substance" is defined as, for Corporations, those whose stock, etc., is directly owned by foreign investor(s) and/or those "designated by a Cabinet Order as being indirectly owned by foreign investor(s) through another company or other companies" owning half or more of the total issue of stock, etc., and for other juridical persons or organizations, those of which a majority number of directors, etc., are non-resident natural persons.

5. "Listed companies, etc." are defined as those "issuing stock which is either listed on the stock exchange defined by Article 2, Paragraph 11 of the Securities and Exchange Law, or designated by a Cabinet Order as being similar to such listed one."

Summary of Revisions of the Foreign Exchange Controls on Capital Transactions

		Old	Revised
1.	Borrowing from banks	Permission required	Free
2.	Overseas lending	Permission required	Prior notice required
3.	Portfolio investment	Permission required	Free when bought from, sold to or arranged by Securities Company; otherwise prior notice required
4.	Issuance of bonds overseas or foreign currency bonds in Japan by resident	Permission required	Prior notice required
5.	Issurance of bonds in Japan by non-resident	Permission required for Japanese investor to pay the subscribed amount to non-resident issuer	Prior notice required
6.	Direct overseas investment	Prior notice required with some restrictions	Prior notice required
7.	Direct investment in Japan	Permission required	Prior notice required Acquisition of listed stocks are free so long as non-resident investors' share is less than the percentage authorized by cabinet order
8.	Acquisition of real estate in Japan by non-resident	Permission required	Prior notice required
9.	Foreign currency deposit by resident with authorized foreign exchange banks in Japan	Free so long as the amount does not exceed ¥3 million, otherwise permission required	Free (no limit on amount)

Notes: (1) "Exchange residents" shall mean all natural persons who have their permanent place of abode or who customarily live in Japan, and also juridical persons (corporate bodies, enterprises), having their seat or place of administration in Japan. The branches in Japan (agencies, establishments, etc.) of exchange non-residents are considered to be exchange residents irrespective of whether they are independent in law or not and even if the place of their administration or their headquarters is located abroad.

(2) "Exchange non-residents" shall mean all persons, natural or juridical, other than those falling under the meaning of exchange residents.

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Assembled and annotated by
Scott Davidson
Staff, Japan-United States Economic
Relations Group

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AGRICULTURAL TRADE ISSUES - U.S.-JAPAN ECONOMIC RELATIONS

The attached papers are summaries of studies prepared for a joint project being conducted by Resources for the Future, Washington, D.C.; and the Japan Center for International Exchange, Tokyo.

The full studies are to be published later this year.

Contents:

Agriculture and Politics in Japan, by Kenzo Hemmi

Agricultural Problems in Japan's External Economic Coordination, by Yujiro Hayami

The World Food Situation: Developments During the 1970s and Prospects for the 1980s, by D. Gale Johnson

Postwar U.S.-Japan Agricultural Relations, by Yutaka Yoshioka

AGRICULTURE AND POLITICS IN JAPAN

Kenzo Hemmi

Political factors play a great role in the determination of Japanese agricultural policies. The peculiar "consensus from below" decision-making process of Japan, in the context of the decline of the LDP (Liberal Democratic Party), is an important aspect of this role. The following discussion examines 1) the relationship of the LDP to farming communities, 2) the question of how much the LDP and other parties' agricultural policies reflect the views of the Japanese people, and 3) the actual decision-making machinery for agricultural policy formation. The LDP is slowly moving away from its rural base and associated policies. Public opinion favors less protectionism for rice but wants more self-sufficiency. Ultimately, the central bureaucracy hammers out most policies with LDP consultation.

The LDP and the Allocation of Parliamentary Seats

Rural communities are a 'strong' political base for the LDP, more than for any of the other parties. A decline in LDP votes followed the postwar decline in size of the agricultural work force (1950, 45% of the total; 1975, 11.4%). Other parties are based mainly on urban constituencies, except for the JSP (Japan Socialist Party) which spans both. The allocation of parliamentary seats has been kept extremely favorable to rural areas. This makes it possible for the LDP to hold a greater percentage of seats than actual votes, thus preserving its majority in the Diet. The ratio of eligible voters in high (urban) and low (rural) districts in 1972 reached a difference of 5 to 1 for each Diet member. Extra urban seats were added to the Diet, but for the 1976 election the difference was still 3 to 1. This is the major factor that has allowed the LDP to retain power. If seats were allocated more equitably according to votes, the LDP would have received only 222 instead of 249 seats.

Since Japan has a 3 to 5 seat constituency area system, most areas contain rural sections. The agricultural groups are better organized than urbanites, and Diet members are thus called on more immediately to answer their demands. If constituencies were smaller, many purely urban ones would be created, and those Diet members could afford to ignore farmer's groups altogether.

The LDP and the Rural Community

What is the nature of the ties between Diet members and farming communities? Agricultural cooperatives (Nokyo) coincide exactly with the structure of local political power. Ambitious young people frequently become Nokyo officials, winning confidence by coordinating farmer's interests and helping with technological know-how. Rising within the Nokyo, they eventually become local politicians. Prefectural and Diet politicians use these men to obtain local votes. They take concern in who is appointed as Nokyo officials. They also work through koenkai (support organizations) headed by local assemblymen. These local groups, koenkai and other organizations engage in intense support activities during election campaigns. The decisive factor in a Diet member's ability to win local loyalities and votes is his ability to meet farmer's demands, and to prominently impress voters with that ability. This is achieved mainly through the procurement of government subsidies for land improvement, roads and other services from which local communities and farmers benefit most.

Formal channels for subsidies begin with the local municipality, then to the prefectural government and the ministry. But since many applications are in competition, local groups must petition their Diet representative to use his influence. If the ministry responds to the Dietman's request, his status in his constituency rises. The ministries respond according to how much a Dietman has helped them previously, by putting pressure on the Ministry of Finance to help them obtain budget allocations, for example. Standing give-and-take relations evolve. More subtly, if one Diet member is particularly influential in a ministry, he can get them to tell local petitioners, "you might get somewhere if you go through Mr. A (Diet member). Then he can claim additional credit. This farmer-Dietman relationship is an arrangement whereby subsidies are swapped for votes. Despite recent talk about "decentralization," the large size of central subsidies will continue, because it is the avenue to power for politicians and the LDP. But Dietmen must also inform their constituencies about the limitations of government policy, which complicates their relationship.

The Rice Price Issue

When the same demand comes to politicians from all farming communities, such as to raise the rice price, voter groups cannot seek individual subsidies but must act en masse. Sometimes the national Nokyo assembles similar regional issues into a common platform demanding broad action, too, such as restrictions on the importation of beef, oranges, and cherries. But the rice price issue has been the major Nokyo policy unifier. Rice holds a kind of "sacred" position in Japan which is practically untouchable in terms of policy. The current staple foods control system is based on the 1942 rationing act. Now it assures farmers a stable high-price purchase of rice.

Overproduction became conspicuous in 1965, resulting in price and production setting by the government. In 1971, even with much surplus, rice prices still increased 3 percent. The LDP was pushing for a 6.3 percent increase, deriving from Nokyo pressure, but was opposed by prime minister Sato. This opposition resulted in some election loss in farming areas. In 1974 there was great strife over the rice price, in the process of coming to terms with farmers facing inflation. The opposition parties supported farmers' demands for a 65 percent hike. This pushed the government hard, and put pressure on LDP factions based in the cities. Pro-rice price hike LDP Diet members, in a pressure group nicknamed the "Viet Cong," demanded a 50 percent increase. Eventually a compromise at 37.4 percent was reached. This Viet Cong group continued to seek favor with Nokyo representatives. But a new faction has emerged which has introduced acreage reduction, and opposes rice price hikes. This new faction was possible because the Nokyo are becoming unionized and can no longer securely direct votes to the LDP. Also, the LDP is worried about losing more urban votes if it supports farmers too much. Therefore in 1977 and 1978 the rice price struggle declined in force. In response the agriculture minister introduced graduated reduction in real prices which were largely accepted by the LDP.

Decision-making in Japan emphasizes harmonious consensus within an organization. Top individuals do not impose decisions, but wait for consensus to form. Collective group action is the norm. This tradition survives best in rural farming communities. Community-size groups are the substructure for local politics and cooperatives, but urban residents are not so organized. Therefore the implementation of national farm policy emphasizes these groups, and the government uses grants as leverage for local control.

Broader Attitudes Toward Agricultural Policies

Urban, opposition parties do not actually oppose agricultural protection. There are several reasons for this: urbanites do not find the burden hard to bear, opposition parties oppose too much food dependency on the U.S., there are many recent rural migrants in the cities, and social capital is poor in the cities, leading city residents to view the countryside favorably.

National sentiment concerning the food problem reflects Japan's past experiences, which amounts to a series of struggles against starvation. During the period 1700 to 1867 many famines occurred. Since the Meiji government began to aid agriculture, there were no more serious famines, but rice riots broke out in 1918. It was in this period that efforts were begun to develop colonial food production. When the colonies were cut off after World War II, food was very scarce until around 1955 when self-sufficiency was achieved in rice. Subsequently, with high economic growth, the diet improved greatly, though dependent on great amounts of imports. Only since 1955 have Japanese enjoyed the extra margin to consume as much as they wish. The ancient specter of famine was reenvoked by the 1974 oil and grain crises, and other developments. Agricultural life is not as idealized as in the West. Village life is often seen as "feudalistic" in social structure and agriculture is considered basically a utilitarian vocation.

A National Food Conference in 1975, attended by the prime minister and other influential persons, declared that a stable food supply for

Japan must be insured. They made the following proposal to the government:

1. Improve capacity for self-suffiency through consolidation of the agricultural structure, such as land and water resources, farmer education and farm price policy.
2. Recognize the necessity of food imports, aid in international food problem solutions, and work for a stable import system.
3. Define a standard Japanese menu and improve school lunches.
4. Improve public information on agriculture; improve living environment of rural communities.

Opinion polls find that about half of respondents are pessimistic about future food supplies, a sentiment which grows stronger in the cities and at times of crisis. A majority of people favor maximum feasible food self-sufficiency. They do not feel that the rice surplus is due to government buying prices being too high, but rather attribute it to the dietary trend toward wheat and livestock products. A majority feel the stable food budget deficit is inevitable. Actually, between 1965 and 1978, expenditures for rice as a percentage of total consumption per household shrank from 6.6 percent to 2.6 percent, accounting for this lack of criticism. However, in recent years there has been a shift of opinion favoring less protectionism, especially among export industries and workers.

Political Parties' Positions on Agriculture

All political parties favor agricultural protectionism. The JCP (Japan Communist Party) and the JSP are the strongest, stressing self-reliance, increased production and acreage, and extending the stable food control system to cover other produce pricing and distribution. The Komeito and DSP, on the other hand, stress consumer interests, and maintenance of the existing level of food production (or increase only through technical improvement) and oppose increased pricing. The DSP (Democratic Socialist Party) calls for selected import targets. The LDP takes a middle position on these issues. It intends to cut deficits in the food control budget and recognizes the international trade necessity to import food. It seeks rationalized farming so that pricing can be reduced without lowering farmers' standards of living. The JSP and JCP criticize the LDP, charging that it would leave small farmers helpless in the face of increased U.S. food imports necessitated by its big-business oriented export policies.

National Agricultural Policy Decision-making

Decision-making in national policy has several aspects. The LDP and the ministries work out acceptable policies between them before introducing them to the Diet. Therefore, the LDP role is simply to assure their smooth passage. The opposition parties do not take part in pre-Diet policy-making, and any bills they themselves introduce almost never pass. They have first contact with the bills and their government representatives in Diet committees, and most Diet time is taken up by opposition questions, which have little impact on the bills themselves, but are good public relations material for opposition Diet members. The parties make deals about which policies to pass soon or delay and obstruct via their parliamentary committees.

The national government (the ministries) has two kinds of relationships with political parties. Usually LDP Diet members are appointed as ministry heads. In this relationship, the minister acts as a liaison between his ministry's concerns and the relevant committee within the LDP. New policies evolve in this context and understandings of the general regulatory implications are worked out before Diet presentation. The second relationship is with the opposition parties, which occurs after basic bills have been set. The government approaches the opposition to ensure that revisions in the Diet will remain within the scope of the already established LDP/government consensus. In general, the parties themselves submit relatively few bills, the government being the main initiator. The government sometimes uses Diet members who are retired bureaucrats as its channel of approach to the LDP, and are in turn influenced by the LDP through these men.

Pressure groups also affect decisions. Farm policy related groups include Nokyo, consumer groups, unions, business and industry organizations and the mass media. Nokyo at one time organized mass "rice price rallies." But this is no longer feasible because of overproduction. Now they emphasize wider policies such as rationalization and regulations of imports. Farmers' organizations have direct tripartite meetings with the Ministry of Agriculture and the LDP Farm Policy Committee to force common understanding. Consumer groups give voice to general public demands, but not with such direct contact. The media amplify these demands. Consumer votes are increasingly important. Labor and business reflect the economy. During rapid growth, high import levels were favored by business to free farm labor. Now, the situation is less clear. Cost and wage priorities argue for more imports, but fears of food crisis urge self-suffiency. Therefore labor and business are not now strong pressure groups. But if fiscal conditions cause higher taxes, criticism of protectionism will mount.

Policy-making within the LDP

Within the LDP, policy deliberation is carried out by subcommittees of the Political Affairs Research Committee, which roughly corresponds to Diet committees in various areas (such as Labor, etc.). There are also research organs such as the Comprehensive Farm Policy Research Committee. Special issue committees are also set up. Individual committee measures are then submitted to the Political Affairs Deliberation Committee, which coordinates them. Then they are submitted to the LDP Executive Council for adoption as official party policy, if they are deemed politically feasible, to be submitted to the Diet.

The government and the LDP are currently reviewing farm policy appropriate to the slow growth era. The government conducts these deliberations through the Farm Policy Delibaration Council, which interacts with the LDP Committee, which channels rural-based views to them. The tripartite meetings with farmers establish credibility which allows smoother decision-making by key LDP Diet members. Opponents of committee proposals fight it out in the Executive Council. Final decisions are often left to the party heads, who have to make the necessary adjustments and compromises. Most acts of legislation result from the adoption of government proposals, so this LDP activity results at most in modifications. The LDP committees try to formulate general ideas in conjunction with the ministries, which the latter then made concrete in the form of bills.

AGRICULTURAL PROBLEMS IN JAPAN'S EXTERNAL ECONOMIC COORDINATION

Yujiro Hayami

In a discussion of the development of Japan's agricultural trade, the reasons for agricultural protectionism, some problems of structural adjustment, and policy implications, Hayami concludes that there need be no trade-off between trade liberalization of agricultural products and rural well-being.

The Development of Trade in Agricultural Products

Japanese agriculture has become a symbol of trade liberalization pressure. Food prices in Japan are high by comparison with other industrialized countries, and this results from a protectionist agricultural policy. But Japan's level of protection is not substantially higher than in other countries, and trade has been liberalized, resulting in significant increases of imports--3.5 times for agricultural products in the 1965 to 1979 period. At the same time, there has been a steep decline in Japan's self-sufficiency in foodstuffs.

The Logic of Agricultural Protectionism

Japan is pressed to liberalize its agricultural trade because of its decisive comparative advantage in manufacturing production and its trade surpluses. Agricultural producers understandably resist being sacrificed to preserve the advantages of other economic sectors. The cost of agricultural protection has been estimated in the late 1960s at 51 percent of agriculture's GDP; compared to Europe's 55 percent and 38 percent for the U.S. about the same time.

Strong protectionism in developed countries is founded on the need to maintain social stability; to rely on the market mechanism might imperil social stability by changing to income differential between farm and city. Other reasons for protectionism include food security and maintaining natural environment havens.

Problems of Structural Adjustment

Liberalization will be resisted not only by farmers, but by all who value the contribution agriculture makes to society beyond its purely economic aspects. The only way to liberalize and maintain a strong agricultural sector is to foster domestic agriculture efficient enough to compete internationally. The JMAFF has been trying to shift resources from production of farm products with low income elasticities to those with high income elasticities and expand the scale of operations since 1961, but it has proved impossible to achieve income equalization through agricultural restructuring alone.

The basic factor limiting Japanese agricultural productivity is small farm size—an average 1.1 hectares of agricultural land per farm. There has been a large increase in the proportion of part-time farmers—individuals staying on the farm, but deriving a substantial part or majority of their income from non-agricultural employment. This has made it difficult for full-time farmers to expand their operational scale. Factors favoring part-time farming include the ease and profitability of concentrating on government-supported and marketed rice farming, attachment to land, and fear that under current land tenure policies to lease or leave the land is tantamount to losing it forever.

Policy Issues

(1) Competitiveness. Part-time farming has inhibited productivity growth and economies of scale but has helped equalize rural and non-rural incomes. Demands of internationally competitive agriculture and preserving social stability can best be met by enabling part-time farmers to stay in rural villages but consign production to full-time farmers. The only way to do this is to activate the land rental market. To do this, there

must be assurances that rented land will be returned to landowners on their request. To be internationally competitive, Japan will also need to encourage specialization where it has a comparative advantage, as the Netherlands did in the nineteenth century.

(2) Rice Prices and Policies. The high level of rice price supports is the main obstacle to restructuring Japanese agriculture; it is now five times or more international levels. Moreover, the budgetary cost of rice programs takes a large portion of government expenditure for agriculture that should be used for restructuring. Because there will be increased Japanese intake of animal protein in future, the shift away from rice should not be toward barley or soybeans as at present, but toward roughage.

(3) Price and Trade Policies. International pressures make it impossible to delay agricultural liberalization until structural adjustments are completed. It is, therefore, necessary to formulate price and trade policies consistent with the maintenance and development of domestic agriculture. In the area of beef, liberalization would generate substantial increases in demand, so liberalization and deficiency payments could meet main objectives of reducing barriers and developing domestic agriculture. On oranges, Japan should seek a quid pro quo of expanded U.S. imports of mandarin oranges and try to expand demand by mixing imported and domestic juices for a better product. Liberalization of agricultural imports can also increase the competitiveness of processed foods. Finally, JMAFF needs to develop better market analysis and policy evaluation capabilities.

(4) Food Security. Three kinds of disruptions could occur: diminished supplies as a result of poor harvests worldwide, wartime

disruption, and a Malthusian crisis. As for the first, any attempt to raise Japan's self-sufficiency to a meaningful extent would necessarily entail socially unacceptable costs. Instead, the answers are diversification of import sources and international stockpiling. As for the second kind of crisis, any war that disrupted food imports would also disrupt oil supplies, and Japan's agriculture depends heavily on mechanization. Means of preparing for such contingencies are domestic stockpiling and expanded livestock farming as cattle could be slaughtered in an emergency and the feedgrain supplies used as food. As for the third contingency, it is not necessary to maintain inefficient domestic agriculture, but to maintain irrigation facilities and land improvements. Land in roughage could be converted to grain as need arose. Moreover, agricultural development in developing countries should be supported. To tie food security to short-term improvement in domestic self-sufficiency not only impedes a more open trading system, but also carries the risk of detracting attention from more effective long-term programs for true food security.

Conclusions

It will be an unprecedented achievement if Japan can create a dual structure of a small number of internationally competitive full-time farmers and a rural majority continuing to hold titles to their land and live in villages earning high incomes, the bulk of which comes from nonfarm occupations. Trade liberalization does not necessarily entail any diminution of rural well-being. This goal cannot be achieved by agricultural policies alone, but must be based on concerted efforts for industrial decentralization, improved transport systems, and other measures to ensure stable nonfarm employment opportunities in rural villages.

THE WORLD FOOD SITUATION: DEVELOPMENTS DURING THE 1970S and PROSPECTS FOR THE 1980S

D. Gale Johnson

Various reasons have been advanced supporting fears that food shortages in the developing countries could worsen; here these reasons are compared with the actual facts of development and world food trade patterns; the study concludes that the major problem is not and will not be shortages per se, but rather lack of income among the poor to buy available food.

Contrary to Prediction, an Increase in Supply of Food

In the 1970s there was great concern that food supply in the developing countries would decline. The reasons given for this were higher energy prices, the near disappearance of new arable land, and the competition between livestock and people for grain. Food supply did not decline. Rather, grain prices declined and there was some per capita food supply increase in low income countries. The reasons for this were, 1)decline in fertilizer cost due to technology improvement, 2)increase in arable land worldwide by more than 5 percent, and 3)three fold increase in export of grain from the developed countries. This provided a large enough increase in grain available to the developing countries to more than offset their increased use of it for feed. Grain production can increase to meet demand.

Contrary to predictions, developing countries experienced an increase in per capita food production from 101.2 (on a base of 100) for 1966-1969 to 10.2 for 1976-1979 (0.7 % annually). The rate of increase of absolute volume of food production was 3.2 percent year, compared to developed countries net import of grain went up 25 million tons to 48 million tons during the 1970s. Some consider this a sign of agricultural failure. But net agricultural exports of these countries were 60 percent in excess of agricultural imports. This indicates the wise use of resources. Analyzed regionally, we find at the extremes that per capita food production (for 1974-1979) among developing countries increased in East Asia by 19 percent, but declined by 9 percent in Africa. Other areas ranged between these two. If developing countries were putting great demand upon world grain supply, prices would rise, but U.S. export prices have continued steadily downward (for the last seven decades).

The Real Reasons for Unavailability of Food

There have been a variety of estimates on the extent of world malnutrition, from 840 million to 400 million (RAO) and much lower. One recent important report stated that hunger increased in the world during the 1970s. However, the author believes it has been decreasing, pointing out that life expectancy in low income countries has increased. He admits there is still much hunger. But it is due to lack of income among the poor strata to purchase food, not to a shortage of food itself. About three-fourths of these poor live in rural areas, so their low income is due to their low agricultural productivity. This must be improved first of all.

There was high price instability in the international grain market in the 1970s. This was not so much due to changes in total volume of production, as to the fact that some countries (the EEC, Soviet Union, Eastern Europe, China and Japan) maintain stable internal price and consumption levels and thereby in times of internal shortage push excessive demand and price increases onto the world market. This instability could easily recur in the 1980s as long as these policies don't change.

Significant Events Changing the Perspective on Food

Two significant surprises affected world food supplies and prices in the 1970s and will probably continue in the future. One was the growth of grain imports by the centrally planned-economies. Total world grain exports increased

82 million tons during the 1970s doubling the total grain trade. Of this increase, the planned economies absorbed 60 percent (half by the USSR). The developing market-economies only took 20 percent (and of that, OPEC took half).

The second surprise was the significant decline in birth rates in many developing countries (China, 39 %; South Korea, 49 %; etc.). This has resulted in a net decline in rate of population growth. This will improve food availability.

Until recently, it was assumed that Chinese agricultural improvement had outstripped that of India. But recent revelations by the Chinese government have admitted that per capita grain production has only about kept pace with population growth (now at 958 million), though no doubt distribution is more equitable than in the past. In terms of aggregate output, China's output is now about 40 percent per capita higher than India's but probably was so before W.W. II also. From 1953 to 1978, total grain production increase in both countries was equal, about 80 percent. China has become the third largest grain importer, while India has reduced its imports since the mid-1970s. We have little accurate data on China's food production, so we don't know if recent high imports are a new stable plateau. China's fluctuations in the future in imports could greatly affect the world food situation.

Unlike the past, food is now available anywhere in the world at the lowest prices of this century, if one has money to buy it. Malnutrition is partly a problem of families of low income buying food to satisfy taste instead of nutrition. This alone causes some to fall into a calorie-intake-level classified as malnourished. The causes for such differences in consumption patterns need research.

Expectation for the Eighties

The modest increases of the past two decades in per capita food supplies in the developing countries can be expected to continue. An even higher rate of growth may occur. Of the three reasons for concern mentioned earlier, we have shown that worries about arable land and grain availability are untenable. What about energy? Prices for it, and therefore, for farm inputs will continue to rise. But the share of fertilizer, oil and fuel in the prices of those inputs only went from 9.1 percent in 1970 to 11.7 percent in 1979 in the U.S. Real grain prices have not changed in the decade. In poor countries, which are less mechanized, this will have even less impact on food price.

New grain varieties and cultivation practices were heralded as a "Green Revolution." Some have shown rather disappointing results. The new varieties could only be used in certain places, and other difficulties occurred. But the doubling of wheat yields and trebling of wheat output in India would have been impossible without the new varieties. Hybrid corn has been continually improved over the last fifty years, and has helped in the quadrupling of yield. These modern hybrids can be expected to do likewise.

Developing countries are now protecting their domestic agriculture better. They are also conducting much more agricultural research. There is also much investment in increasing irrigated land available. There is also a growth in real per capita income in low and middle income developing countries projected (30 % or more in the next ten years). These factors will help increase food during the 1980s. Slower population growth will take longer for strong effects to appear. The main key to an adequate food supply is taking political policies which help farmers produce more.

POSTWAR U.S.-JAPAN AGRICULTURAL RELATIONS

Yutaka Yoshioka

The history of food trade, Japanese internal agricultural policy, and the position of various groups and organizations on these issues are vital aspects of U.S.-Japan agricultural relations. This study emphasizes Japanese concern about the food supply, and urges greater mutual understanding.

Background to Current Trade Relations

Agricultural reforms enforced upon Japan by the GHQ broke up the power of the landowners, distributed land to those who actually worked the land, and established agricultural cooperatives, services and research activities. The new owners adopted new technologies and greatly increased rice yield, producing high self-sufficiency for Japan. This allowed foreign exchange to be used to build industry. The more prosperous farmers also became a large internal market for manufactured goods. (On the other hand, land reform has had the negative impact of preventing proper use of economies of scale.) In the immediate postwar period, American grains and milk saved many Japanese from starvation, and changed diets in the process. Both of these policies created much of the goodwill in Japan vis-a-vis the U.S. which still remains.

Japan joined GATT in 1955 and engaged in tariff negotiations with the U.S. and other countries. Since then, there has been great liberalization of tariffs and import restrictions (from 456 items to 19 in agricultural items under quantitative restrictions). There has also been a great increase in food demand in Japan caused by rapid economic growth, and this, together with mechanization, has increased internal productivity, but problems of small scale and high price supports still plague Japanese policymakers. To meet its internal demand, Japan has become one of the three largest agricultural importers in the world.

Response of Different Sectors of Japanese Society to Trade Liberalization

The negotiations over agricultural imports have been difficult. The U.S. always urges Japan to specialize in industrial economy and open up to even more U.S. agricultural products. But the Japanese farm sector and the agriculture ministry believe that protecting agriculture, similar to the EC, is basically necessary. They feel the U.S. is too concerned about temporary balance of payments problems. It is more important, considering Japan's internal social and political stability, that a dependable total supply of food be secured. Even without any common understanding, great liberalization has occurred.

Various sectors within Japanese society reacted differently to the strong U.S. pressure for liberalization during times of severe trade imbalance. Typically the ministries, centrally MITI in consultation with the LDP, draw up a liberalization plan in passive response to this pressure, emphasizing those products which are least valued or vulnerable. The government and business community try to compensate the affected industry for its losses.

The chief proponents of liberalization within Japan have been competitive export manufacturing industries. Some unions supported liberalization due to its favorable effect on consumer prices, but with recent world instability they have become less vocal. Agricultural organizations strongly resisted liberalization, saying it would damage that sector and impair Japan's self-sufficiency. These differences were reconciled mainly within the LDP Agricultural and Fishery Committee. The high growth of Japan's economy pushed rapid liberalization. But new various factors, such as instable world conditions in energy and food supply, fishing restrictions, stagnant internal food demand and the LDP need for a strong rural political base, are pushing for greater protectionism. The main criticism today is that price supports are not improper trade policy, but a financial drain.

The postwar period saw a decrease in Japanese agricultural exports, notably silk. Agricultural organizations under government guidance now tailor production of various products to fit the domestic market. Japan now imports over $13 billion in agricultural products, and only exports $400-$500 million. While greater exports are recommended, there is insufficient support for this in Japan.

Agricultural and Trade Policies in Japan

The United States price support system for main agricultural products changed early in the 1970s to a system of target price with direct government payments and rice supports at world market rates. In most cases, Japan still uses the price support system, at prices much higher than the world market. Imports of some commodities are regulated by quota or state trade, which are more flexible than the EC levy system. Japan's original agricultural plan was to diversify its products and specialize its producers in order to lower price supports towards the world market level. But with rapid economic growth, to keep farmers income up with laborers, even higher price supports were necessary. Also, an enormous number of farmers moved to the cities. This led to an almost complete cessation of internal production of wheat, soy, etc. Seventy percent of Japanese farmers now depend on non-farming jobs for their major income. This is indirectly responsible for the great increase in imports of wheat, and other agricultural products from the U.S.

While this is a boon to U.S. farmers, Japanese farmers feel that they should have more share of their domestic market. They attribute the liberalization of trade to the weakness of the government.

Due to the harsh experience of wartime, Japanese have a near obsessive concern with minimal food security. Each administration makes promises in this realm, and opposition parties always focus their criticisms of the government on this issue. The best institutional expression of this anxiety is the Food Agency of the Ministry of Agriculture, Forestry and Fisheries which buys, stores, prices and distributes rice and wheat. Even during crises such as in 1973, the prices set by the Agency remain steady. Between 1973 and 1976, world grain prices were high and the agency accumulated a 419 billion yen deficit in order to preserve stable prices. Yet when world prices drop, or the yen strengthens, the agency may show a profit on wheat imports, but this incurs U.S. criticism. Japan does not actually aim at raising total self-sufficiency, but simply to maintain current levels based on general production and demand forecasts. How well the U.S. can comprehend these stabilizing policies will greatly affect future agricultural relations.

Recent Japanese Concerns about Food Supply

In 1973, the oil shock and soybean embargo reactivated Japanese food fears. Soy prices rose and panic ensued. The government responded by assisting private stockpiling. While soy imports were not cut off, consciousness of food dependency heightened. The consumer movement, which once supported lower prices and liberalization, changed to support for increased domestic production despite the inevitability of higher prices. Japan became concerned that fluctuations in Soviet food import demands could suddenly affect supplies again and to feel that in the last analysis

U.S. export policy will favor stable domestic prices and be subordinate to diplomatic decisions in times of high demand or crisis. Logically Japan wanted to secure minimal internal food supply. Thus, in 1973, a new long-term basic policy was formulated, stressing better international information flow, aid to developing countries' agricultural production, Japan-U.S. trade guarantees (Abe-Butz), building domestic reserves, and some increase of domestic wheat and soy production. The U.S. has kept its agreement to never again restrict food exports, and so regained credibility. However, Japanese are still concerned that agricultural exports are linked to diplomatic purposes in some way.

Prospects for the Eighties

In the 1980s, many more changes will occur. The grain supply is destabilizing due to various factors such as energy and currency problems, and the U.S. will have to give more protectionist considerations to its smaller and marginal farms. Japan's economic slowdown and internal food market surfeit makes further raising of price supports difficult. New Japanese policies should aim at higher productivity in products competitive with the EC. Along with reduction of rice production (by one-fourth of present acreage), new crops will compete to some extent with hitherto unchallenged U.S. imports like wheat soybeans. Therefore, the U.S. and Japan must work to understand each other's agricultural systems and policy targets in order to achieve a smooth relationship.

LEGAL PROTECTIONISM IN THE UNITED STATES AND ITS IMPACT ON UNITED STATES-JAPAN ECONOMIC RELATIONS

A Study Prepared for the
ADVISORY GROUP ON UNITED STATES-JAPAN ECONOMIC RELATIONS
("The Wise Men Group")

by
Carl J. Green,
Member of the Bars of the District of Columbia
and the State of New York

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FOREWARD

This study has been prepared for the Japan-United States Economic Relations Group which was established at the behests of the President of the United States and the Prime Minister of Japan to submit recommendations that would help to maintain a healthy bilateral economic relationship between the two countries. In response to the request received from the Group, the study examines certain aspects of American law affecting imports sometimes characterized as "multiple harassment," "multiple jeopardy," or "legal protectionism," (the latter term being preferred by the author.) The Group did not request the author to survey any comparable problems that may be present in Japanese laws or administrative process and no implications as to their existence or non-existence should be drawn from this study.

The author is grateful to many well informed persons, too numerous to list here, who, reflecting diverse points of view, offered helpful and instructive comments on earlier drafts of this paper. Responsibility for the views expressed herein and for any errors or omissions is solely that of the author.

INTRODUCTION AND SUMMARY

Over the past decade, protectionism in the United States has taken on a new and sophisticated form. Traditional protectionism, as manifested by the Burke-Hartke bill of the late 1960's sought to create a wall of high tariffs and quotas around the American marketplace. The new protectionism, which takes the guise of a defense of "fair trade," utilizes a variety of laws originally designed to deal with specific trade abuses as instruments to achieve general reductions in imports.

The terms "fair trade" and "unfair trade," are rich in emotive content, but exceedingly difficult to define. The laws that purport to define "unfair trade"--the antidumping law, the countervailing duty law, section 337 of the Tariff Act of 1930, and section 301 of the Trade Act of 1974--are themselves extremely broad. The antidumping law uses a variety of alternative technical formulae to define dumping with the result that it is often impossible for an importer to know in advance of a legal proceeding whether prices are above or below the "fair value" standard. The countervailing duty law condemns as "unfair" various kinds of subsidies practiced by foreign governments that are essentially indistinguishable from subsidies routinely provided by the United States Government. The other unfair trade statutes, section 337 and section 301, are so broadly drafted as to give little indication of their intended scope. Indeed the major conclusion of our review is that there is no objective yardstick of fairness in the context of international trade. Fairness means essentially what the Congress, the International Trade Commission and the courts say it means.

The uncertainty of the trade laws, and in particular of the dumping standard is itself a significant trade barrier. The fact that importers generally cannot know what prices or practices will be condemned as unfair naturally tends to inhibit price competition and thereby to serve a protectionist interest. In addition the multiplicity and overlap of the trade laws, combined with various substantive and procedural features of the law, tend to create incentives for domestic firms to use strategies of legal harassment to impose costs, delays or penalties on their foreign competitors. As a result, the perception is spreading in Japan and elsewhere that the United States market, though basically "open," has become a hazardous and hostile environment in which to do business.

We have used the term "legal protectionism" to describe the use of the unfair trade laws as instruments for achieving protectionist purposes. Our review of the development of this phenomenon over the past decade suggests that it is neither a spontaneous growth nor the result of any single policy decision. It is a complex phenomenon brought about by the interplay of various factors. The existence of protectionist pressure itself is readily understandable as a result of the spectacular growth of international trade, the increasing strength of industries in other countries, and the progressive reduction of tariff barriers through the GATT and Multilateral Trade Negotiations. But the shape that protectionism has taken in the United States has been determined by choices made by Congress and the Executive Branch as well as by private sector action.

An important factor in the development of legal protectionism has been the long-standing tension between Congress and the Executive Branch over trade policy. The broadening of the unfair trade laws in the 1974 Trade Act and in the Trade Agreements Act of 1979 can be seen, in effect, as a price exacted by Congress for having provided the Executive the authority to negotiate general tariff reductions. In the 1974 Act, Congress lowered the injury and causality requirements for imposition of import restrictions, expanded the definitions of "dumping" and of "unfair trade" generally and added new legal bases for import relief. In the 1979 Trade Agreements Act a variety of provisions of a procedural nature were added to the unfair trade laws designed to make them "more effective" from the point of view of domestic complainants. Although the Executive Branch has remained strongly committed to liberal trade, it too contributed to the growth of legal protectionism when in the steel import crisis of 1977, President Carter urged the domestic industry to use the unfair trade laws, particularly the antidumping law, as an alternative to quantitative restraints.

Another important factor in the rise of legal protectionism is, rather paradoxically, the impact of the antitrust laws. This is paradoxical because the antitrust laws are designed to promote competition, including competition from abroad, and the Justice Department is often an ally of foreign firms in antidumping or other unfair trade cases. But the antitrust laws tend to force trade disputes into the mold of unfair trade litigation by precluding, in most cases, negotiated settlements and making even voluntary export restraints risky. Moreover they create additional legal risks that enhance legal protectionism's harassment potential. Faced with the threat of antidumping complaints, foreign exporters might seek, for example, to agree to maintain minimum prices, but such action, even if undertaken solely to comply with the dumping law, would run afoul of the antitrust law's proscription against price-fixing.

It is true, of course, that Americans generally are more litigous than Japanese (or most other people) and that, to some extent, anyone seeking to do business with the United States must be prepared to face legal risks. But it would not be accurate to say that the risks faced by foreign firms and importers are merely the same as those faced by American businesses. The unfair trade laws discussed in the paper apply only to those engaged in the import trade. While the antitrust laws apply both to domestic and foreign businesses, foreign firms face special antitrust risks arising out of the conflicts between the antitrust laws and the unfair trade laws.

How serious a problem is legal protectionism? There is no way to quantify the answer. The major effect of the uncertainties and risks associated with legal protectionism is to deter competition. It is no more possible to know how effectively legal protectionism deters competition than it is to know how effectively the criminal laws deter crime. One can count the number of trade cases just as one could the number of criminal prosecutions but that would be meaningless as an indication of the law's deterrent effect. What is clear is that the problem is perceived as serious by numerous Japanese and other foreign businessmen as well as by numerous lawyers and economists specializing in international trade.

Moreover, legal protectionism, whatever its extent, seems clearly to be undesirable in principle. For domestic industries in need of adjustment assistance or temporary shelter from sharp trade swings, the "protective" value of legal protectionism is limited given its delays and costs and the uncertain and haphazard nature of the relief it provides. On the other hand, most foreign traders would probably prefer a more orderly and certain business environment, even at the cost of slower export growth. And from the point of view of the United States Government, legal protectionism would appear to be a highly unsatisfactory substitute for an affirmative trade policy. The inconsistent outcomes of trade litigation and the often inappropriate remedies that the process provides complicate the management of America's international trade relations and contribute to friction with trading partners and to a growing tendency toward retaliation by foreign governments.

Protectionism is often referred to as merely a future threat in the United States. This study suggests that protectionism of a sophisticated kind is a present reality and is growing. Recognition of the phenomenon of legal protectionism and of the dangers it poses to the U.S.-Japan economic relationship and to the world economy generally provides a necessary starting point for development of better solutions to international trade problems. The aim of this study is to assist the Japan-United States Economic Relations Group to identify such solutions. Specific recommendations are set forth following the text of the study.

I. What is Unfair Trade?

The enormous expansion of world trade over the past two decades, while bringing great benefits to the American economy generally, has placed great strains on various industries affected by international competition. At the same time America's trade balance has been adversely affected by the growth of imports and particularly by the greatly increased oil imports bills that followed the formation of OPEC. These factors have generated strong protectionist pressures at both the industry and the national levels. In the early years of the last decade, protectionist interests lined up behind the Burke-Hartke Bill in an effort to recreate a wall of high tariffs and quantitive restraints around the American marketplace. This effort failed, and the Executive Branch went on to negotiate further tariff reductions and trade liberalization measures in the Tokyo Round. But the failure of Burke-Hartke did not defeat protectionism; rather it was one of a number of factors that channeled it into a new form, one which we describe as "legal protectionism".

Legal protectionism, broadly defined, is the use various laws dealing with "unfair trade" to achieve general reductions in imports. Legal protectionism has not entirely replaced the traditional quotas and tariffs described in economics textbooks; rather it has added to them a wide range of sanctions including Orderly Marketing Agreements (OMAs), antidumping and countervailing duties, plus what might be called "indirect tariffs" in the form of damages, penalties and harassment under various trade and antitrust laws. Although several of the legal weapons employed by legal protectionism are of venerable age, they are now being used in new and sophisticated ways. Viewed as whole, the phenomenon of legal protectionism is quite different from anything the world economy has experienced in the past and it presents new and formidable challenges to the international trade system in general and to U.S.-Japan economic relations in particular.

The key element in legal protectionism is the expansion of the concept of "unfair trade". In the past this was a narrow and specialized legal term used to refer to infringements of patents, trademarks or other industrial property rights and, in another context, to certain predatory practices. In recent years, however, the concept has been expanded to include a wide variety of practices that most economists would regard as normal and, indeed, inevitable concomitants of international trade. The attachment of the "unfair trade" label to these practices makes it possible for protectionist interests to use laws designed to deal with specific abuses as instruments for the achievement of broad protectionist purposes.

A. The Antidumping Law

The two major cases of "unfair" import trade are those of dumping and subsidies. Dumping is classically defined as price discrimination between national markets or more specifically as the sale of goods at a lower price abroa than in the home market. From an economic standpoint, it is clear that price discrimination in different markets is not necessarily an abuse. According to elementary laws of economics, prices are determined in competitive markets by supply and demand or, in oligopolistic or monopolistic markets, by what the traffic will bear. Since any two markets are likely to have different demand elasticities and supply conditions for a given product, it would follow that the product would fetch different prices in those two markets. To condemn all instances of price discrimination, therefore, would be to challenge quite fundamental principles of economic logic.*/

Price discrimination which is of a temporary or sporadic nature does present problems. Dumping is clearly an abuse where it is a temporary strategem designed to drive out competition. But such instances are rare, particularly in a market as large and as resistent to monopolization as that of the United States. Some few years ago Matthew J. Marks, then Deputy Assistant Secretary of the Treasury, wrote: "As one who has had considerable practical experience in administering the American Antidumping Act of 1921, I can say there has never been a case with which I have come into contact which I am prepared to categorize as predatory dumping."*/

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*/ In economic theory there is a "law of one price" that says in a perfectly free and competitive world economy in which everyone had perfect access to information and there were no time lags, a given commodity would fetch the same price (except for freight differentials) everywhere. The theory is essentially equivalent to the truism that if the entire world were one market there should be only one market price. In the real world, however, different national markets (as well as supra-national and sub-national markets) do exist, and the "law of one price" does not affect the propositions stated in the text.

Other temporary dumping, e.g. to liquidate inventories, utilize temporary overcapacity, or penetrate new markets, may also be the cause of market disruption and injury to domestic industries. As such it is a legitimate concern of antidumping legislation. Article VI of the GATT Agreement states, in part, that "dumping... is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party..." The GATT's condemnation of dumping, it should be noted, is conditional on it having a casual relationship to material injury. Dumping, per se, is not condemned. The American antidumping law on the other hand proceeds from the very different (and economically dubious) premise that all dumping is bad. The home market price (or its substitute as described below) is defined as "fair value," and any sale in the United States at less than that price is classified as unfair trade. Proceeding from this starting point the American law reflects quite different attitudes toward the injury and causality standards.

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*/ Matthew J. Marks, "United States Antidumping Laws-A Government Overview",43 Antitrust Law Journal 580,581 (1974).

To illustrate, in the course of the Tokyo Round of Multilateral Trade Negotiations, the United States was persuaded, over great resistance, to include in its laws a requirement of "material injury" as a condition for imposing dumping duties (previously the law referred to mere "injury"). During the hearings on the Trade Agreements Act of 1979, which incorporated the substance of the MTN Agreements into American law, importers and representatives of America's trading partners argued that material means "important, significant, substantial." Congress rejected this formulation as too restrictive and instead defined material injury as "harm which is not inconsequential, immaterial or unimportant."*/ Congress' reasoning in adopting this apparently low standard reflected its blanket condemnation of price discrimination. As stated in the Report of the House Committee on Ways and Means: "the Committee does not view overall injury caused by unfair competition, such as dumping, to require as strong a causation link to unfairly competitive imports as would be required for determining the existence of injury under fair trade conditions."**/

The actual meaning of the "material injury" standard under the 1979 Trade Agreement Act will depend upon the interpretations given to it by the United States International Trade Commission and the courts. It would be premature to speculate, therefore, on whether the Act derogates from United States obligations under the GATT. In the case of many countries, international treaties such as the GATT automatically became part of the law of the land and there is no opportunity for legislative reinterpretation of treaty commitments. United States international practice, however, distinguishes between self executing treaties, which automatically have the force of law, and non-self executing treaties which, to become effective, must be incorporated into domestic legislation. The GATT and the MTN agreements are non-self executing and thus only the domestic law that implements the treaties, (and not the treaties themselves) can be introduced into American courts as legal authority. A foreign firm which believed that it was being subjected to antidumping duties under a provision of American law not consistent with the GATT would have no recourse in American courts. Its government, however, could seek a remedy under the dispute resolution mechanisms of the GATT.

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*/Section 771(7) (A) of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979.

**/House Report No. 96-137 (Ways and Means) to accompany HR4537, The Trade Agreements Act of 1979, 96th Congress, 1st Session (1979) p.47.

Compounding the problem of loose injury and causality standards is the fact that the American antidumping law is an extremely complex and technical statute. Some of the complexities are inherent in comparing sales prices of "such or similar merchandise" in two different markets. There are often significant differences in the merchandise offered in different markets because of varying consumer preferences, varying safety and performance standards, etc.

Moreover, differences in distribution practices, warranty obligations and other factors complicate price comparisons. The most difficult legal problems under the statute, however, usually arise in determining what constitutes "fair value". While home market sales provide the starting point for such a determination, a provision of the Trade Act of 1974 authorizes the administering authority in certain circumstances to disregard home market sales below "cost." Leaving aside the enormous complexities of determining "cost," the 1974 amendment can and does lead to quite anomalous results. If home market sales below cost are disregarded, the selling price of the merchandise in the United States is compared not with average home market prices but only with _average home market prices that are above cost_, a generally higher figure. To illustrate, assume that costs in the home market are 10, that 75% of the merchandise is sold in the home market at a price of 8 and that the remainder is sold at 12. The average home market price would be 9. Under present law, however, sales below cost would be disregarded so the resulting average home market price would be 12. Merchandise sold in the United States for less than 12 would be treated as sold for less than fair value.*/ In other words, dumping may be found even where United States prices are both higher than cost and higher than the average prices in the home market.

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*/ See Matthew Marks, "Remedies to 'Unfair' Trade: American Action against Steel Imports", _The World Economy_, Vol.1, No. 2, p.223, 231.

By authorizing disregard of home market sales below cost, the 1974 amendment may also result in findings that there are insufficient home market sales to form a basis for comparison so that another method of determining fair value must be used. Under United States law, if there are insufficient home market sales, the administering authority may, at its option, measure fair value by reference either to third country prices (the administering authority has wide latitude in choosing which third country to use) or to "constructed value". The calculation of constructed value is based on cost factors but includes rather arbitrary minimum figures for general expenses (10% of costs) and assumed profit (8% of costs and expenses).

The net result of these complexities and arbitrary rules is that the application of the American antidumping law is highly unpredictable. Thus, instead of being a litmus test of unfair trading, the antidumping law might more accurately be described as a trap not only for the unwary but even for those trying diligently to maintain fair prices. This view was inferentially supported by Robert E. Cassidy, General Counsel to the United States Trade Representative, in recent testimony: "It is doubtful whether many manufacturers in a foreign country can know whether dumping, in the technical sense, is occuring."*/

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*/ Testimony before the Subcommittee on International Trade of the Senate Finance Committee, March 11, 1980 reported in "American Metal Market", March 13, 1980.

The Countervailing Duty Law

The United States also attaches the "unfair trade" label to all manner of subsidies affecting the manufacture, production or exportation of imported goods. Its position on this question also contrasts with the views reflected in the recently negotiated MTN Agreements on Subsidies and Countervailing Measures. The Agreement states, on the one hand, that "Signatories shall not grant export subsidies on products other than certain primary products" (Article 9 (1)), demonstrating recognition that subsidies designed to promote exports do distort international trade and are properly regarded as an abuse. But, on the other hand, the Agreement also states:

> Signatories recognize that subsidies other than export subsidies are widely used as important instruments for the promotion of social and economic policy objectives and do not intend to restrict the right of signatories to use such subsidies to achieve these and other important policy objectives which they consider desirable ...

The distinction between export subsidies and "other than export" subsidies is not made in the laws of the United States. The Report of the Senate Finance Committee on the Trade Agreements Act of 1979 condemns all subsidies with something approaching theological intensity:

> Subsidies and dumping are two of the most pernicious practices which distort international trade to the disadvantage of United States commerce. Subusidies are bounties or grants bestowed (usually by governments) on the production, manufacture or export of products, often with the effect of providing some competitive advantage in relation to products of another country. Subsidized competition may harm U.S. producers in our own domestic market or in foreign markets for U.S. exports. Countervailing duties are special duties imposed to offset the amount of the foreign subsidy.*/

Because of the difference in view reflected in the above, it has not been possible to achieve multilateral agreement on a definitive list of subsidies subject to countervailing duties. The MTN Agreement includes a list of export subsidies but the list is termed merely "illustrative". Under American law the list of potentially countervailable subsidies includes not only all of the items on the illustrative list but also such practices as:

i) The provision of capital, loans, or loan guarantees on terms inconsistent with commercial considerations;

ii) The provision of goods and services at preferential rates;

iii) The grant of funds or forgiveness of debt to cover operating losses sustained by a specific industry;

iv) The assumption of any costs or expenses of manufacture, production, or distribution.**/

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*/ Senate Committee Report No. 96-249 (Finance) to accompany HR453 The Trade Agreements Act of 1979, 96th Congress, 1st Session (1979) p. 37.

**/ Section 771(5) of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979.

These broad categories may be interpreted to include many practices in which governments, including that of the United States, regularly engage. For example, low interest loans or other concessions to industries in depressed regions, or to firms owned by disadvantaged minorities would fit within such categories. For the United States or any other country to declare all subsidies unfair is to engage in self-condemnation.

The term subsidy itself poses great difficulties of interpretation, as illustrated by two interesting cases. In one, the Customs Court of the United States held that the Japanese practice of remitting its commodity tax on exported products (television sets) constituted a subsidy subject to countervailing. This decision, which put the Japanese exporters in the position of being "unfair traders", was in direct conflict with Article VI(4) of the GATT. A major international trade dispute was averted when the Customs Court's decision was overturned by the Court of Customs and Patents Appeals and the Supreme Court affirmed the latter's decision.*/ The other case is a long standing dispute in the GATT as to whether or not the tax deferral accorded to exporters by the DISC legislation in American law constitutes an export subsidy. The United States has defended that case with the argument that the term subsidy as used in the GATT is not broad enough to encompass a tax deferral.**/

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*/ Zenith Radio Corporation vs United States 437 US 443 (1978).

**/ See John H. Jackson, "The Jurisprudence of International Trade: The DISC Case in GATT". 72 American Journal of International Law 747 (1978).

Given the widespread practice of governments in providing "subsidies" to achieve social and economic purposes on the one hand and the broad reach of the American countervailing duty law on the other it can be expected that legal disputes in this area will continue to grow. As in the case of the antidumping law, the United States, pursuant to the MTN Agreements, has now included a standard of "material injury" in its countervailing duty law. (Previously there was no injury requirement except in the case of duty-free goods.) This may moderate the imposition of countervailing duties in some cases. But because of the American view of subsidies as inherently "unfair", the definition of "material injury" included in the countervailing duty law (the same as used in the antidumping law) appears to be framed so that the requirement may rather easily be met.

Section 337

Other laws concerned with "unfair" practices in import trade include the antitrust laws, which we will discuss below, and Section 337 of the Tariff Act of 1930. The latter is a broadly worded statute prohibiting "unfair methods of competition and unfair acts in the importation of articles into the United States." Prior to certain amendments to the statute made by the 1974 Trade Act, Section 337 was limited in practice to cases involving protection of patents, trademarks and other industrial property rights. Following the 1974 amendments, however, the International Trade Commission took the position that Section 337 was to be applied to any case coming within its broad language, including actions relating to dumping and subsidies. It thus became a redundant weapon that could be used in addition to actions under the antidumping or countervailing duty law to harass importers of foreign goods.

The Administration opposed this overlapping use of Section 337[*/] and, in the Trade Agreements Act of 1979, the problem of Section 337's overlapping coverage was dealt with by a provision stating that the International Trade Commission shall not conduct an investigation under Section 33 "if it is based *solely* on alleged acts" within the purview of the countervailing duty or antidumping laws (emphasis added). But since, by implication, the Commission may undertake Section 337 investigations based *partially* on allegations under the other laws, it is not clear whether Congress really intended to eliminate the redundancy. As a practical matter petitioners may need only to add a routine allegation of conspiracy or of intent to injure competition to bring Section 337 and the heavy civil penalties it carries into play. Substantively, aside from its application to industrial property cases, it is difficult to see what Section 337 adds to the antidumping and countervailing duty laws on the one hand and the antitrust laws on the other in defining "unfair trade."

[*/] *Certain Welded Stainless Steel Pipe and Tube*, 43 Fed. Reg. 8304 (ITC), *disapproved by President*, 43 Fed. Reg. 17789 (

Section 301

The statutes described above relate to "unfair" import practices. Yet another statute authorizes import restrictions on foreign goods on the grounds, inter alia, that the country of origin deals unfairly with American exports. Section 301 of the Trade Act of 1974, as amended by the Trade Agreements Act of 1979, authorizes the President in sweeping language to "take all appropriate and feasible action within his power" to enforce the rights of the United States under any trade agreement or to respond to any act, policy or practice of a foreign country that (1) "is inconsistent with the provisions of, or otherwise denies benefits to the United States under, any trade agreement" or (2) "is unjustifiable, unreasonable or discriminatory and burdens or restricts United States commerce". Among the actions specifically authorized are the suspension of trade agreement benefits, the imposition of duties or other import restrictions on foreign products or of fees and restrictions on foreign services. The President may invoke the powers of Section 301 either on his own motion or in response to a petition.

A major question in regard to Section 301 is how its use will relate to the international dispute resolution mechanisms provided for in the GATT and under the MTN Agreements. As these mechanisms have been established by the international community, with the active participation of the United States, specifically to deal with a broad range of international trade disputes, it can be expected that unilateral action outside the framework of, or otherwise inconsistent with those mechanisms will have an adverse impact on the international trade system.

Section 301 is not, in its terms, limited to uses consistent with agreed international dispute resolution mechanisms and the explanatory langauge used in the House and Senate reports is somewhat ambiguous on this point. The House Report, for example, states that Section 301 is:

> to provide a comprehensive domestic mechanism for the United States to utilize the new international dispute settlement provisions under the GATT and the MTN agreements, to pursue and enforce its rights under international trade agreements, and to seek the elimination of other acts, practices or policies of foreign countries which impose an unjustifiable or unreasonable burden or restriction on U.S. Commerce (emphasis added).*/

The statutory and explanatory language thus give rise to the inference that Section 301 may be invoked to "retaliate" against foreign acts, policies, or practices which are authorized or not prohibited under the relevant international agreements. It is not clear on what basis such acts, etc. may be classified as so unjustifiable or unreasonable as to bring the weighty sanctions of Section 301 into play.

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*/ House Report No. 96-317 (supra) p. 172.

Section 201 (The Escape Clause)

Unlike the other provisions listed, Section 201 of the Trade Act of 1974 is not concerned with any misconduct on the part of a foreign exporter or government. It provides that in any case where the International Trade Commission finds that increased imports are "a substantial cause of serious injury, or threat thereof" to a domestic industry, it can recommend that the President provide relief. The relief may take the form of an Orderly Marketing Agreement, duty increase, tariff-rate quota, or quantitative restriction.

Authority for emergency import relief is provided for in Article XIX of the GATT, the so-called "Safeguards" clause. That clause, however is considered by many countries to be overly restrictive in that it requires that relief measures be consistent with most-favored-nation treatment and also that the invoking country provide compensation or face retaliation for its emergency action. There has been an increasing tendency over the years for countries to bypass Article XIX's restraints. One of the major purposes of the Tokyo Round was to reach a new international accord on safeguards, but this effort ended in failure.

The OMAs authorized by Section 201 cannot be reconciled with the principles of Article XIX since, as agreements negotiated on a country-by-country basis, they do not conform to the most favored nation principle. While their ostensibly consensual character may insulate OMAs from direct conflict with GATT obligations or with the most favored nation provisions of United States Treaties of Friendship, Commerce and Navigation (e.g. Article XIV of the U.S.-Japan F.C.N. Treaty), the fact remains that they do discriminate against the products of a single country and are, hence, rather drastic remedies. Thus, although Sectio 201 purports to be a "fair trade" provision and does have higher injury and causality standards than the unfair trade provisions, the OMA remedy it provides seems more appropriate for the latter. This is presumably why when the President determined to negotiate an OMA on Japanese television sets in 1977, he cited various alleged unfair trade practices in justification for the action.

The foregoing review suggests that Congress' interest in finding ways to protect domestic industries injured by foreign competition has resulted in considerable broadening of the concept of unfair trade as well as in a tendency to punish even what is admittedly fair trade. Instead of being a definable legal norm, the term "unfair trade" often merely reflects subjective notions of distributive justice. A famous headline some years back in "The Economist" summarized the matter well. It read: "I Export; He Dumps."

The Development of Legal Protectionism

Legal protectionism is a product of the conflict between the demands of various industries for protection and the continuing commitment of the Executive Branch to a liberal international economy. It is not the result of any single policy decision nor is it, as some might argue, a spontaneous, private-sector phenomenon. Legal protectionism has been made possible by legislation, encouraged by executive and legislative policy, and given shape by private sector action.

Three major milestones stand out in the development of legal protectionism. First, in response to an industry-led campaign, the 1974 Trade Act established a sharp dichotomy between the treatment to be accorded to "fair" and "unfair" trade and generally eased the standards for relief against imports, particularly those that could be classified as "unfair". As we have noted, it added Section 301 to retaliate against unfair import restrictions and export subsidies maintained by other countries, broadened the language of Section 337, and introduced into the antidumping law a set of new provisions based on the troublesome concept of "cost".

The Carter Administration's handling of the 1977 steel crisis was a second milestone in the development of legal protectionism. In response to rapidly rising imports of foreign steel, the American steel industry made urgent demands on the Administration for quantitative restraints (quotas or OMAs). The Administration resisted these pressures because of its concern about the international consequences of such outright protectionist action. But instead of leaving the domestic industry emptyhanded, the President issued a statement sharply attacking unfair trade practices by foreign steel manufacturers and pledging more vigorous enforcement of the antidumping laws. He even charged the Treasury with a 'derogation of duty' for failing to enforce the antidumping law more effectively in the past. In effect, the President converted the industry's demand for quantity restraints into a strategy for limiting imports through the price mechanism (dumping duties). The domestic industry responded positively to the President's approach and within a month of the President's statement, some sixteen antidumping petitions were filed relating to $1.6 billion in steel imports.*/

To deal with the subsequent crisis in international steel trade, the Administration devised an arrangement called the Trigger Price Mechanism. This involved an undertaking by the Government that it would automatically launch an antidumping investigation with respect to any foreign steel sold below the "trigger price," an amount corresponding to the calculated cost (including expenses, profit and freight) of Japanese steel, the Japanese steel producers being deemed the world's most efficient. This undertaking was coupled with an understanding that the domestic producers would withdraw their antidumping petitions and refrain from further such petitions. The effect of the TPM was to provide the American steel industry with the protection of a price floor on foreign competition while providing foreign producers with a measure of certainty regarding the application of the antidumping law. The protection afforded domestic producers was not, however, sufficient to satisfy all of them and in late March 1980, United States Steel brought a new set of antidumping petitions against European steel imports. In response, the Government immediately suspended the operation of the TPM.

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*/See Matthew J. Marks, op.cit.

The passage of the 1979 Trade Agreements Act marks the third milestone. This is an ironic fact since the 1979 Act is the instrument for incorporating into American law the substance of the Tokyo Round of Multilateral Trade Negotiations, a principal purpose of which was to reduce or eliminate non-tariff barriers to trade. The MTN, however, fell far short of earlier expectations in this respect. The negotiators failed to reach agreement on a new code on safeguards and succeeded only to a limited degree in narrowing differences on antidumping and countervailing duties.

The major apparent change of substance in American law introduced by the Trade Agreements Act was, as we have noted, the inclusion of a standard of "material injury" as a condition for the imposition of antidumping or countervailing duties. In exchange for this uncertain concession, the United States Government used the Act as the vehicle for a number of provisions designed to make the antidumping and countervailing duty laws "more effective" from the point of view of domestic industries seeking relief. In the past, for example, countervailing petitions were frequently rejected by the Treasury Department if they failed to identify specific subsidy practices. The discretion of the administering agency to reject petitions has now been reduced by a series of new provisions that limit to twenty days the time during which petitions may initially be considered; that lower the standard of evidence needed to support such petitions; that require the United States Trade Representative to assist private parties in collecting information useful for their petitions; and that require publication of the reasons for rejecting petitions in the Federal Register. In describing these measures, the Report of the House Committee on Ways and Means states: "the Committee expects that the Authority will act upon most petitions, rejecting only those which are clearly frivolous, not reasonably supported by the facts alleged or which omit important facts which are reasonably available to the petitioner".*/

The 1979 Act also reduces the amount of time available for the conduct of both antidumping and countervailing duty investigations. In the past, for example, a period of 12 months was not uncommon for a countervailing duty investigation; now, except in "rare, extraordinarily complicated cases" investigations must be completed within 160 days. It can be expected that such time restrictions will complicate the burdens of defending antidumping and countervailing duty actions and may encourage arbitrary decisions on the part of the administering authorities. Other innovations in the Act also seem likely to work against the interests of foreign firms and importers. These include the following:

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*/ House Report No. 96-317 (supra) p.51.

-- The burdens of defense will be increased by various technical requirements for holding on-the-record hearings; translation of all documents into English and verification of all information submitted, including information received from foreign governments; new rules on the availability of confidential information; etc.

-- Various restrictions are imposed upon settlement of trade cases, including a requirement that the complaining domestic industry be consulted before any settlement is approved.

-- The new law clarifies that judicial review will now be available for all tentative decisions not to conduct full investigations.

-- Administrative responsibility for enforcement of the countervailing duty and antidumping laws is now transferred from the Treasury to the Department of Commerce. It might be noted that, as the latter is the agency specifically charged with promotion of U.S. industry interests, questions of impartiality and fairness inevitably arise.

In passing the 1979 Trade Agreements Act, Congress made no secret of its veiw that there ought to be more rather than fewer trade actions in the future. For example, the House Committee on Ways and Means stated in its report: "The Committee feels very strongly that both the countervailing and antidumping duty laws have been inadequately enforced in the past"*/ and, further: "The Committee is of the view that strong, aggressive and persistent enforcement of U.S. unfair trade practices law is an essential element in a sound, broad based, trade policy.**/

Another effort further to strengthen the instruments of legal protectionism is now under consideration in Congress. In addition to the antidumping law we have described, the United States has an older statute, the antidumping provision of the Revenue Act of 1916 (15 U.S.C. Section 72), which imposes criminal penalties on persons who engage in dumping with predatory intent and also authorizes private parties injured by such dumping to recover three times their actual damages. This statute has seldom been invoked and never successfully enforced. Under legislation now pending before the United States Congress (S. 223, "the Danforth Bill"), the requirement of intent in the 1916 Act would be eliminated. Strong support for this legislation has been expressed by various industry groups. The Administration, on the other hand, despite its frequent condemnations of dumping as an unfair practice, has opposed this Draconian remedy.

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*/ House Report No. 96-317 (supra) p.48.

**/ idem. p.51.

Against this background it would be difficult indeed to argue that the growth of American legal protectionism has been a spontaneous or "private sector" phenomenon. The explanation does not lie in some inherent litigiousness in the American character. It is rather that protectionism, a not incomprehensible phenomenon under the conditions of recent years, has been channeled into its litigious form by Government policies and legislation. On the one hand, the GATT and subsequent multilateral trade agreements have largely precluded the use of quotas and high tariffs to achieve import limitation. (The role of tariffs has also been greatly diminished by the adoption of the system of floating exchange rates.) On the other hand, for reasons discussed below, the American antitrust laws and antitrust policy have greatly restricted the possibility of negotiated, consensual arrangements for easing trade pressures. The legal protectionism we are witnessing is the outcome of this squeeze.

As a general proposition, it would seem reasonable to assume that most foreign exporters dealing with the United States are interested in sound, long-term trade relationships. They recognize that sudden upsurges in exports are dangerous and counterproductive. The notion that there are large numbers of foreign firms interested in destroying American competitors or monopolizing the vast American market is part of a primitive demonology that bears little relationship to business realities. Most major foreign exporters, including those of Japan, would no doubt be willing to exercise self restraint in export growth and to negotiate voluntary industry arrangements designed to prevent sudden, disruptive shifts in export volume. Such arrangements are now common, for example, in Japan-EEC trade.

In the case of the United States, however, voluntary industry arrangements are deemed to be precluded by the Sherman Act, which prohibits all agreements "in restraint of trade". Further, the United States Government, in response to dicta in a leading case,*/now takes the position that it itself, and its officials, are precluded from negotiating agreements with foreign firms to limit imports without specific legislative authority. Indeed, in testimony given March 18, 1980 before the House Ways and Means Committee in connection with automobile trade, the United States Trade Representative stated that "serious antitrust questions would be raised if, without legal authority, the Executive Branch encouraged, either directly or indirectly, the use of voluntary export restraints by other countries." Any foreign firm which voluntarily restrains its exports to the United States invites prosecution under the antitrust laws on the grounds that it may be acting in response to an explicit or implicit request from the United States Government or its officials or from its domestic competitors.

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*/ Consumers Union of U.S. v. Kissinger 506 F. 2d 136 (1974), cert. den. 421 US 1004 (1975).

With consensual arrangements for import relief unavailable, the only recourse, under the present system is to legal proceedings under the unfair trade laws or the Escape Clause (the distinction between them being, as we have noted, less clear than the labels "fair" and "unfair" trade suggest). It is this fact, rather than any innate American proclivity for litigation, that explains the growth of legal protectionism.

III. The Problem of Harassment

Exposed to growing international competition as a result of the GATT and MTNs, and prevented by the antitrust laws from negotiating agreements to moderate that competition, American industries have increasingly turned to strategies of legal harassment under the "unfair trade" laws. Illustrating the harassment possibilities provided by those laws are the series of actions taken over the last decade against Japanese television manufacturers. These included:

-- a set of private antitrust actions brought by domestic electronics manufacturers, beginning in 1970, seeking treble damages totalling some $1.5 billion. These actions, which allege violations of the Sherman Act, the Robinson-Patman

Act, the dumping provisions of the Revenue Act of 1916 and the Wilson Tariff Act, remain pending.

-- A complaint before the Treasury Department which resulted in a finding of dumping in 1971. Efforts to compute and collect the dumping duties stretched over the decade of the 1970's. On April 28, 1980, the Department of Commerce (which took over the responsibilities of the Treasury Department under the antidumping law) announced that it had settled its claims for some $138.7 million in dumping duties on television sets imported through March 31, 1979 for approximately $76 million. Representatives of American manufacturers who regarded the settlement figures as too low immediately brought legal action to enjoin the proposed settlement, and obtained a preliminary injunction on May 9, 1980.

-- A countervailing duty action alleging that Japan's remission of commodity taxes on exported merchandise constituted a countervailable subsidy. As noted, the Treasury's denial of the claim was appealed up to the Supreme Court, which resolved the case against the complainants.

-- A section 201 (Escape Clause) Action commenced before the International Trade Commission. This led eventually to an Orderly Marketing Agreement concluded in May, 1977 limiting imports of Japanese color television sets for a period of three years to 1.75 million units in each year (down from roughly 3 million in the year preceeding imposition of the OMA.)

-- An action under Section 337 of the Tariff Act alleging unfair trade practices, which was settled by a consent order.

-- A lobbying effort to obtain Congressional pressure to have the Justice Department undertake a full criminal and civil investigation of the Japanese manufacturers before a grand jury based upon the "check price" system imposed by the Japanese Government at the behest of United States authorities. The Justice Department ultimately declined to launch a full investigation, but did commence a preliminary investigation in July 1977 that consumed 200 person work days and involved examination of 35,000 pages of documents.

It is neither our purpose to comment on the merits of the above actions nor to allege that they necessarily reflected a concerted strategy of harassment.*/ They are referred to solely to demonstrate the range and scope of actions that can and did arise out of the one basic allegation that the prices of Japanese television sets sold in the United States were unreasonably low. While the television cases present the most extreme case of what has been termed "multiple harassment," somewhat similar patterns have been repeated in other industries.

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*/ Indeed such a concerted strategy might itself be illegal under the antitrust laws. See interview with Douglas Rosenthal, Chief of the Foreign Commerce Section of the Justice Department's Antitrust Division, in "Japan Economic Survey", a publication of the United States-Japan Trade Council, August 31, 1979.

Significant potential for harassment arises out of the fundamental conflict between the trade and antitrust laws, a problem that needs to be examined in some detail. Section 1 of the Sherman Act of 1890 prohibits any contract or combination in restraint of trade, including, for example, arrangements controlling prices, dividing markets, or providing exclusive territorial dealerships. Section 2 of that Act prohibits predatory practices aimed at monopolization. Violations of the broadly worded Sherman Act can lead to criminal or civil actions by the United States Government or to private actions for recovery of damages. In the latter case the plaintiff can sue for and recover three times the amount of its actual damages ("treble damages").

The Sherman Act, on the one hand, and the trade laws, on the other, embody basically conflicting policies. The former, of course, is intended to promote competition among both American and foreign firms. That competition will result in injury to some firms is understood by antitrust advocates; such is the price to be paid for an open, competitive market. As long as a firm does not seek to monopolize an industry or to injure other firms through predatory or discriminatory prices, it is free to compete in accordance with market considerations. In contrast, the trade laws are essentially anticompetitive in that they seek to restrict foreign competition that might be injurious to American firms.

As a result of this basic conflict, it often happens that the Antitrust Division of the Justice Department will seek to advance the cause of competition by intervening in trade actions on the side of foreign firms. For example, the Antitrust Division opposed the use of Section 337 in the Welded Stainless Steel Pipe case on the grounds that that principally involved a dumping allegation. It has intervened in a number of antidumping proceedings to argue, for instance, that alleged injury by reason of less-than-fair value (LTFV) sales should not be found where those sales merely match equally low prices of a domestic firm.*/ In these and other cases, the Antitrust Division's participation has, no doubt, been helpful in protecting competition and in alleviating some of the burdens of defense faced by foreign firms. But the Antitrust Division's record of success before the International Trade Commission is not strong, and its intervention in trade actions on behalf of foreign firms gives no assurance that the latter will prevail.

In other situations, foreign firms subject to protectionist threats or proceedings may find their problems compounded by American antitrust law and policy. Efforts to avoid the Scylla of trade litigation can place foreign firms in the Charybdis of antitrust prosectuion. For example, if foreign firms try to avoid trade litigation through concerted action, e.g. by agreeing to keep their prices above the presumed "fair value" standard of the anti-dumping law, they will be subject to prosecution under the Sherman Act for entering into a "contract or combination in restraint of trade." This poses a severe dilemma. In many cases, particularly where there is more than one foreign firm in the U.S. market, price competition among them carries grave risks of antidumping law violations. But agreement to fix prices constitutes a per se violation of the Sherman Act.

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*/Joel Davidow, Director, Office of Policy Planning, Antitrust Division, United States Department of Justice, "U.S. Competition Law, Nontariff Barriers to Trade and the Role of the Antitrust Division", Speech before the 32nd Conference on Aids and Safeguard Measures in International Trade Law, University of Liege, Belgium, October 19, 1979.

To alleviate the dilemma in certain specific cases, the United States Government has relied on the rather anomalous device of asking foreign governments to require their firms to maintain a minimum price. The check price system imposed on Japanese television exporters by their Government is one example. Based on a somewhat uncertain line of judicial authority, the Justice Department has taken the policy position that it will not prosecute foreign firms for arrangements entered into under the legal compulsion of their government acting within its jurisdiction.*/ It is not entirely clear how firm this non-prosecution policy position is. As noted above, the Justice Department did undertake a preliminary investigation of Japanese television manufacturers acting under the check price arrangement imposed by their Government. While the result of the preliminary investigation was to find "no reasonable basis" for pursuing a full investigation, the fact that it took place at all casts some doubt on the Department's position. But whatever the position of the Justice Department may be, private parties are free to bring treble damage antitrust actions against foreign firms at will. Whether and how the foreign legal compulsion (or Act of State) doctrine is applied depends on the decisions of judges in individual cases.

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*/ The leading authority for the application of the "Act of State" or "foreign legal compulsion" doctrine under the antitrust laws is a dictum by Judge Cashin in United States v. The Watchmakers of Switzerland Information Center, Inc., 1963 Trade Cases Par. 70,600 (S.D.N.Y. 1963).

There are other differences between Justice Department policy and the practices of private litigants under the antitrust laws. By its terms, the Sherman Act applies to both the domestic and foreign commerce of the United States. But the foreign commerce of the United States is also the commerce of Japan, or France, or Italy. The Justice Department can be expected to recognize the foreign policy problems that would result from unlimited assertions of American jurisdiction. While it has gone further than other governments think appropriate (as illustrated by the United Kingdom's Protection of Trading Interests Bill), the Justice Department has generally not sought to probe the outer limits of Congress's authority. It has also undertaken obligations to consult with other governments, including the Government of Japan, before bringing actions directly affecting their interests. But these restraints and procedures do not apply to private litigants. They can and do bring antitrust actions that stretch jurisdictional claims to extreme lengths.

Another difference is in the types of cases that the Justice Department and private litigants bring under the antitrust laws. Because of the practical difficulty of "monopolizing" the American market through predatory pricing and in view of the benefits of low prices to consumers, the Justice Department "will usually be reluctant to devote a great deal of effort to pursuing foreign firms which do no more than sell at low prices".*/ On the other hand, private litigants can readily pursue both antitrust complaints and trade actions. For example, they may petition for relief under the antidumping law and at the same time bring an antitrust action on the grounds that the foreign firm's pricing policy was part of a conspiracy to drive out competition. For these and other reasons the trade law/antitrust law tangle provides a rich store of harassment potential.

Various incentives for bringing harassment actions are built into American laws and legal procedures. One incentive for multiple actions arises from the fact that the uncertainty of the law cuts both ways; complainants can seldom be sure what kind of action will result in relief. If they pursue only one action and lose, they may not have a second chance. More aggressive complainants may see in multiple actions the possibility, strongly suggested by the television cases, of piling multiple liabilities and losses on their foreign competitors. Such liabilities may include money damages payable to the complainant or special duties which directly increase the selling price of the competing imported goods. In addition, there is the possibility of obtaining quantitative restrictions on imports through an OMA, as in fact happened as a result of the escape clause action on television sets.

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*/Davidow, op. cit.

The amounts claimed from the Japanese television manufacturers in the form of treble damages, dumping duties, countervailing dutes, etc., not to mention the losses resulting from the restrictive OMA, are, of course, enormous. But from the point of view of a protection-minded domestic firm in that or other industries, the effectiveness of legal harassment actions does not necessarily depend upon prevailing in a court of administrative forum. Even "unsuccessful" legal action can impose very high costs upon foreign firms in the form of legal fees and related costs (including preparation and translation of documents, etc.), executive time and travel, and the like. In contrast, the costs borne by the complaining domestic industry in antidumping and countervailing duty actions are usually limited to those involved in preparing a petition. Once the petition is filed the work of investigation is borne by U.S. Government agencies. Complainants are not obliged to post bonds when they file petitions and they pay no penalties if they lose, even if their claims are groundless. While complainants in private antitrust actions are likely to incur substantial legal costs, typically the differential costs of defending antitrust actions are higher, especially where the defendant is a foreign firm that must bear heavy costs for translation, transportation and communications in connection with its defense. Since such differential costs must ultimately be reflected in the prices at which goods are sold, one can roughly analogize their effect to that of tariffs.

Moreover, by intimidating foreign firms and diverting the time and attention of their managements, harassment actions can be very effective in disrupting efforts at market development. They can cause delays in product sales that produce competitive losses. And in some cases they may succeed in making foreign firms withdraw simply to avoid further harassment. These are strong incentives to harassment, and unless they are moderated, there is great danger that harassment will increase and invite retaliations damaging to the international trading system.

The Consequences of Legal Protectionism

Legal protectionism is still a new phenomenon and it strains the conceptual framework with which we are accustomed to think about international trade issues. We typically analogize protectionism to a "wall" and equate it with "closed" markets. The United States market, despite its web of OMAs and other restraints, remains basically open. The "wall", by and large, is permeable. But, once inside, foreign businesses confront a set of obstacles that might well be described as a legal minefield. A minefield, from the point of view of its intended victim, is characterized by multiple hazards and by uncertainty as to their location. The multiplicity of the trade and antitrust laws and the uncertainty of their application support the metaphor.

The uncertainty of the law is itself a significant trade barrier. The fact that a foreign firm cannot know at what point its prices may fall below the "fair value" standard inevitably creates pressures for maintaining artificially high prices. In a sense the effect of uncertainty is analogous to that of tariffs, but a foreign firm faced with a known tariff is free to compete to overcome the tariff disadvantage. Uncertainty is a more difficult barrier in that it makes competition risky at any level. When uncertainty is combined with the potential for multiple penalties, damages and costs, it becomes a powerful deterrent to competition.

Thus it is not clear whether the minefield we have described represents a major improvement on the wall it replaces. Clearly from the point of view of protection-minded domestic industries, it is of less than optimal effectiveness. Notwithstanding the hazards involved, foreign exporters have increased their shares of numerous markets. For domestic industries in need of adjustment assistance or temporary shelter from sharp trade swings, the remedies provided by legal protectionism are uncertain and their value is reduced by the delays and costs of bringing them into play. On the other hand many foreign businessmen are clearly unhappy with legal protectionism and it may be presumed that many would settle for somewhat smaller market shares to avoid the uncertainties and risks they face under the present system.

From the point of view of the United States Government, legal protectionism would also seem to be highly unsatisfactory. For one thing it does not appear to satisfy protectionist political pressures at home. Secondly the reactive nature of the approach tends to encourage further protectionism rather than the development of America's export capacity. As a recent report of the Comptroller General of the United States points out, instead of encouraging strong industries, American trade policy, through its reliance on relief measures, tends to support weak ones.*/ The longer weak industries are protected against more efficient foreign competition the more protection they are likely to require. Hence the result tends to be a vicious circle.

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*/ Comptroller General of the United States, United States-Japan Trade: Issues and Problems, September 21, 1979. p.iii and 189-190.

Moreover, the uncontrollability of the system (a feature which will likely grow under the judicial review procedures provided in the 1979 Trade Agreements Act) results in inconsistent standards and inappropriate remedies that impede effective management of international trade relations. The tensions generated by the system feed what Harald Malmgren has described as the "politics of blame" and thus adversely affect U.S. relations with other countries. One consequence is growing retaliation against American exports in many countries of the world.

The politics of blame are having an especially deleterious effect on United States-Japan economic relations. In the United States there is mounting criticism of the Japanese as "unfair traders" and a growing tendency to blame them for a wide variety of America's economic ills. Among the Japanese there is a growing sense of being scapegoated by Americans and growing resentment over accusations that are perceived as false and unjust. These tendencies, if left unchecked, can do serious damage to the otherwise strong fabric of Japanese American relations.

In the view of the author the politics of blame are to a large extent the outcome of the processes described herein as legal protectionism. In the interests of better Japanese-American economic relations, it is essential that we find better ways of managing our trade disputes. The recommendations set forth on the following pages are offered for this purpose.

V. Recommendations

1. Undoubtedly the most desirable alternative to legal protectionism (or any other form of protectionism) would be a set of affirmative policies for improvement of productivity, for adjustment assistance to declining industries and for the reduction of dependency on foreign oil. While such policies would not necessarily eliminate all trade friction, they would greatly reduce its intensity and contribute to a healthier American and international economy.

2. Ideally, free trade should be bounded only by those restraints necessary to eliminate genuine abuses such as certain temporary or predatory dumping, export subsidies and infringements of industrial property rights. Experience suggests however that the size of international trade coupled with the rapidity of shifts in comparative advantage and in differential growth rates among nations produce overloads that the system cannot readily handle. Legal protectionism, whereby the categories of abuses are expanded to achieve broad imports restrictions, is an illogical and inefficient way of dealing with the problem. At best it is a stopgap on the way toward an affirmative trade policy; at worst it, and the retaliation it provokes, may severely damage the international economy. The threat needs to be faced squarely and dealt with by appropriate legislation to reduce the breadth, the uncertainty, and the harassment potential of the trade laws.

3. The conflict between the trade laws, with their policy of restraining foreign competition and the pro-competition antitrust laws produces not a creative tension but rather an uncertain and hazardous business environment. Greater coordination of American trade and antitrust policy is called for. While Americans are rightly aware of the dangers of cartelization, there would be significant benefits in relaxation of the antitrust laws sufficient to permit agreements for more orderly shifts in trade patterns. In order to ensure that such agreements are consistent with the public interest, legislation would be required setting forth standards and providing for appropriate government participation and/or review.

4. In recognition of the fact that international trade necessarily involves the interests of more than one sovereign state, and taking into account the fact that different trading nations have different views regarding the best ways of maintaining healthy competitive marketplaces, it is recommended that the United States and Japan take the lead in exploring the possibility of an international convention to define the limits of national jurisdiction over restrictive practices in international trade. Such a convention would alleviate a major irritant in the relationships between the United States, with its doctrine of extraterritorial antitrust jurisdiction, and its trading partners.

5. The United States and Japan, in concert with other trading countries, should redouble their efforts to

achieve multilateral agreement under the GATT on a realistic and effective system of safeguards, on a definitive list of countervailable export subsidies and on an improved antidumping code which distinguishes between temporary, disruptive dumping and legitimate price discriminations resulting from the interplay of economic forces.

6. In recognition of the importance of an orderly dispute resolution mechanism for international trade issues the United States and Japan should work together to strengthen the dispute resolution mechanisms provided under the GATT. Consistent with that system, Japan and the United States should engage in regular and frequent high level consultations on bilateral trade issues.

7. Recognizing that issues of law play a major role across the entire spectrum of the United States-Japan economic relationship (e.g. in regard to bilateral trade and investment; finance, transportation and other services; and the rights of individuals to pursue their professions and livelihoods), it is recommended that the President and the Prime Minister authorize or encourage the establishment of improved arrangements for consultation and dispute settlement in legal matters. In this connection the Draft Treaty on the Settlement of International Dispute between Canada and the USA, published September 20, 1979 by the American and Canadian Bar Associations, is an interesting and instructive model that bears careful study.

Comments on a Paper Prepared by

Carl Green

for the Japan-U.S. Economic Relations Group

entitled

"LEGAL PROTECTIONISM IN THE UNITED STATES AND AND ITS IMPACT ON UNITED STATES-JAPAN ECONOMIC RELATIONS"

by

Douglas E. Rosenthal

November 1980

Comments on a Paper Prepared by Carl Green for the Japan-US Economic Relations Group entitled "Legal Protectionism in the United States and Its Impact on United States-Japan Economic Relations"

I will begin by summarizing the essence of the legal protectionism argument. The following is a paraphrase which I put in quotation marks to emphasize that this is not my view.

> "The system of U.S. trade law (anti-dumping, countervailing duties, Section 337, escape clause and related statutes) has developed, like topsy, as a protectionist barrier to the free access of imports into U.S. commerce. It has developed, incrementally, by officials of the U.S. Government, inclined toward free trade in the abstract, who have made repeated ad hoc compromises with private sector interests leading to a labryinth of legal rules and procedures easy for domestic industries to exploit to injure imports. The trade law system has led to a relatively consistent pattern of harassment of imports and has encouraged rather than placated protectionist pressures. While the trade law in itself is bad enough, its harm is compounded by the contradictory standards of the antitrust law which discourages foreign firms from making private compromises that would effectively placate U.S. protectionist pressures and lead to mutually satisfactory resolution of trade conflicts if permitted. Because of the antitrust threat the route of reasonable compromise is removed.
>
> As a remedy, the trade law should be trimmed of protectionist bias leaving only those provisions which relate to 'genuine abuses' and antitrust law should be relaxed to permit private settlement of trade disputes between U.S. and Japanese industries. These settlements, presumably, would involve either or both an agreed higher export price of quantity restrictions for exports to the United States from Japan. Furthermore, there should be a U.S.-Japanese initiative to draft an international convention to define the limits of national antitrust jurisdiction and, presumably, thereby limit the overly aggressive foreign commerce enforcement of the Department of Justice."

There has been a tension between the free trade orientation of Executive branch officials who are responsible for the conduct of U.S. foreign policy and particular domestic interests seeking protectionist relief in times of economic difficulty. This is a tension found to some degree in every developed country, including Japan. The legal protectionism paper suggests that this is a problem that really emerged with the "milestone" of the 1974 Trade Act. I think it goes back well before the mid-1950s to an earlier milestone, Congress' taking away from Treasury and giving to the then - Tariff Commission (an agency under closer Congressional supervision) jurisdiction to determine whether domestic complainants were entitled to tariff relief due to importer dumping. Carl does not stress, as I would, the importance of the conflict between the Congress and the Executive branch over who determines trade policy, a conflict which also goes back at least to that earlier period.

U.S. trade law has been heavily influenced, on the whole (but not entirely) for the worse, by Congressional mistrust of executive bureaucracy -- mistrust both of its competence and of its motivation to reflect and be accountable to the popular will. The salient fact about U.S. trade law is that, alone among the trade regimes of our major trading partners, it does not permit our chief executive to factor public or national security interest standards into relief determinations in the two vital trade areas of dumping and subsidies. No other nation's executive policymakers, so far as I have been able to determine, are similarly encumbered.

Limitations on Executive Branch authority in the most recent trade statute are attributable, I suspect, to this longstanding tension between Congress and the President as exacerbated by two recent events largely unrelated to any surge of protectionism. One event is the failure of the trade law process to dispose of the Japanese color TV complaints for ten years after an affirmative dumping finding was made. (This matter has just, finally, been resolved by settlement between the Commerce Department and the foreign TV suppliers, but the validity of the settlement is being challenged by the U.S. industry.) This heightened Congressional disillusionment with the motivation and competence of executive bureaucrats. As I state below, it should have, instead, brought a reappraisal of the inflexible legalistic approach of the trade law itself.

The other critical event was Watergate. The Watergate Affair intensified public and Congressional mistrust of general executive responsibility. This post-Watergate crisis of confidence has not yet run its course. Until we redress the balance and confer more authority on the President to conduct trade policy in a manner more consistent with the broad range of U.S. foreign political and economic policy there will continue to be problems with U.S. policy making in the trade area regardless of the ebb and flow of protectionism

The legal protectionism paper exaggerates the strength of protectionist pressure over the past seven years in contrast, presumably, with an earlier "golden age" of free trade consensus. It points, for example, to the establishment of the trigger price mechanism (TPM) for imported steel as a protectionist milestone. TPM, in hindsight, seems a reasonable compromise at the time to a very serious worldwide problem. It also exaggerates the harm to free trade that has been done under such U.S. trade law provisions as the Escape Clause, Section 337 and Section 406. Those statutes at least provide the President with the opportunity to reflect public and national security interests in the application of the law and because of that, and because recent presidents have generally acted responsibly, those statutes have been reasonably applied in support of a generally (though not perfectly) free trade policy. For example, the Carter Administration has resisted extension of TPM to industries other than steel and it acted responsibly in suspending TPM once the U.S. Steel anti-dumping complaint was filed. The reimposition of TPM at a critical stage during the recent Presidential election campaign reflects an attempt at compromise. This does not evidence a serious pattern of legal protectionism in the application of U.S. trade law.

Yet another indication that the new trade law is not an automatic protectionist steamroller is the record to date of the International Trade Commission (ITC) in rendering preliminary injury determinations in dumping cases. The ITC has dismissed several dumping complaints at the preliminary injury review stage and one of the fears of potential abuse, that the ITC would "rubber stamp" unsubstantiated complaints for full scale Commerce and ITC investigations, has not been realized.

The author of the legal protectionism paper has not asked to consider Japanese practices in it. This omission leads to the implication that the preoccupation in U.S. trade law with unfair Japanese and other foreign conduct is unwarranted. It is impossible to have a dialogue on U.S.-Japanese relations without recognizing that responsibility for present trade problems must be shared. For example, it is a departure from free trade when the major firms in a Japanese industry, with government assistance, jointly cooperate to mutual advantage, but to the detriment of foreign customers, suppliers and competitors. Customer channeling in the U.S. to prevent U.S. customers from playing one Japanese manufacturer off against another is one example. Buyer cartels to avoid competition among Japanese customers in dealing with U.S. suppliers is another. Joint access to Japanese Government-financed research only for Japanese enterprises in an industry, not U.S. subsidiaries located in Japan, is a third. These are practices which in the United States are generally considered unfair and inappropriate in our markets. Furthermore, while it is true that substantial efforts have been made in the past few years to open up Japanese markets to American exports, previously there was pervasive protectionism in Japan. It was excused on "infant industry" grounds as Japan struggled to develop its post-war industrial base and, perhaps, by what some commentators have referred to as the Japanese self-image of weakness and vulnerability requiring protection against powerful foreigners. By not alluding to this, the asymmetry of the critique of American protectionism is even more manifest. As I will say below, U.S. trade law has not succeeded in defining precise and objective standards of unfair trade practices. Nonetheless, there have been and continue to be unfair trade practices in Japan and elsewhere adversely affectin American interests, and the effort to understand more precisely what these practices are, why they cause harm, and how they can be reduced, is an important agenda item for this Group and for others concerned about international economic policy.

Just as it is a mistake to view current problems with U.S. trade law and policy as an amalgam of intensified, one-sided U.S. protectionism and U.S. governmental weakness, it is also an error to make so broad an attack on the legal character of our trade policy process (though, below, I am also critical of certain aspects of its legalism) and especially, to conclude that its legal nature is a diabolic device to ensnare the foreigner. One of the conditions of doing business in the U.S. for American domestic as well as foreign enterprises is operating within a framework of elaborate and overlapping legal rules and procedures which have as their objective more the achieving of a just result than an efficient result. It is not simply the trade laws that are preoccupied with the distinction between fair and unfair, legal and illegal, conduct. Those distinctions permeate the full fabric of our law.

Consider, for example, the "multiple harassment" faced by an American corporation at risk of losing a multi-million dollar foreign contract if it fails to match the bribe offered a foreign government official by its principal competitor. If a bribe is offered (even without the authorization of top management) and its offer is discovered, the U.S. management may be liable not only under the Foreign Corrupt Practices Act (FCPA), but also under the internal revenue law, the securities law (if it is a corporation with publicly traded stock), and a shareholders derivative suit to recover the bribe payment personally from those responsible for making it. The deep moralism of the American people, the desire to be right even at personal cost, is reflected in the FCPA in a manner which is unmagineable for any other country in the world. It is this moralism combined with our reluctance to trust any single authority to deal with trade issues that is most responsible for creating the admittedly overly complex and duplicative structure of our trade law. A new surge of support for free trade will not change it.

In addition to our greater trust in laws than in men and our preoccupation with justice reflected in the legalism of our trade law, there is yet a third factor more important in explaining the present system than protectionism. That element is a belief that even at this early stage of relative inexperience with the complex new problems of international trade, it is already possible to identify conduct that is clearly unfair, possible to produce unambiguous evidence demonstrating such conduct; possible to fashion precise standards for application to even complex technologies and across the full range of transnational cultural and political systems; and that it is possible to fashion remedies to reflect these distinctions without compromise and without need for accommodation to related international military issues, and conflicting foreign and domestic political and economic concerns. The new trade law is grounded in these notions. They are largely wrong. That is its biggest problem.

This is illustrated in Treasury's inability, over ten years, to determine the comparability of color televisions produced in Japan for the Japanese market with TVs produced in Japan for sale in the United States, and to determine and apply fair dumping duties. The comparability of complex products such as television sets for sale in different markets is, given our present knowledge, not precisely determinable. Nor is the constructed value of a Polish-made golf cart as if produced in Spain. Accountants have told us that even such fundamental concepts as profit and total cost are imprecise and subject to varying interpretations by experts of equal competency applying the same American standards of generally accepted accounting principles consistently applied. How much more impossible to make an "objective," precise determination of constructed value or, less than fair value sales in foreign markets, with foreign accounting practices, foreign data aggregated in foreign language categories, and all values subject to the vicissitudes of fluctuating foreign exchange rates. That Treasury failed to accomplish the impossible should neither surprise nor anger us. I do not expect the newly-empowered Commerce Department to do much better. It is not humanly possible.

Furthermore, it is naive to assume that our trading partners should or can draw no linkage between the way our trade law affects their exports to us and the concessions and commitments we seek from them on political, military and unrelated economic matters. Do we really expect European governments to risk a harder line political policy toward the Soviet Union for our (and, to a lesser extent, their) benefit if we impose heavy dumping duties on their steel exports? Our current trade law does not permit us to take such public interest and national security objectives into explicit account in resolving the steel complaint. Implicitly, of course, it is inevitable that these factors will be reflected. Human beings do not operate in a value-free vacuum like machines. But does it make sense to have a trade law that, by its terms, is supposed to be nonresponsive to externalities, like a doomsday device, merely to "show those damn bureaucrats?"

General contours of trade law reform lie not in limiting it, as the paper suggests, to "genuine abuses" -- which begs the question. What abuses are "genuine?" What factors "cause" injury? What types and degree of injury should be remedied? The trade law is supposed to have clear answers to these questions. But the answers are anything but clear. Rather, it lies in a more open policy process, more transparent to Congressional and public scrutiny, coupled with greater centralization of trade authority, giving discretion to the Executive Branch to overrule ITC dumping and subsidy relief determinations where it is in the national interest to do so and where such interventions are candidly explained and fully justified. Then, if the policy is unpopular, we can vote the President who took it out of office or the President can fire his trade officials. It also lies in more flexible standards flexibly applied by the ITC, especially to take account of "other factors" than import competition that often cause the injury to a complainant.

In contrast to the paper's point of view, I do not think it either possible or desirable to abandon a legal approach to trade disputes. I share John Jackson's view that "rule oriented" decision-making is fairer and more predictable than "power oriented" decision-making. A similar point has been made by Professor John Jackson. (See, e.g., "The Crumbling Institutions of the Liberal Trade System," 12 Journal of World Trade Law 93 (April, 1978).) It is not that our rule oriented law is rule oriented, but that the present rules are too precise, too arbitrary and too narrowly drawn at this stage in the law's development. By trying to fashion a full-blown body of trade law, with little room for common law development reflecting case by case experiences and broader political and economic realities, we force reality into artificial categories. There is a middle ground between unprincipled discretion on the one hand and totally non-discretionary rules on the other. That is the ground on which we should now be standing. However, the present trade law does not permit it.

I was asked to comment specifically on the suggestion that the worst features of the trade law would be obviated if U.S. antitrust law did not prevent Japanese and American trade associations from resolving private trade disputes privately. It is difficult to see how principles of free trade would be furthered by a weakening of antitrust enforcement. To exempt import trade from U.S. antitrust law is to reject 90 years of American law, policy and experience. The last time U.S. trade associations were allowed to engage in collusive arrangements for orderly marketing was under the NRA during the Great Depression. Most experts agree that NRA was a failure which intensified the Depression without benefiting even the protected industries themselves. The paper complains that present U.S. trade law encourages U.S. domestic industries to use it to attack import competition. Opening the door for American trade associations to press for private foreign export restraints and higher export prices will hardly act as a disincentive to protectionists.

If we let U.S. trade associations indulge in cartel-like compromises with Japanese trade associations, without governmental, public interest oversight, in lieu of trade litigation, how do we justify not letting them divide markets among themselves domestically? How would we keep such a relaxation of antitrust enforcement from degenerating into the system of worldwide private cartels such as those during the inter-war period which many experts consider to have intensified worldwide economic stagnation?

The implication of the paper is that Japan's trade relations with Europe are a more appropriate model. While individual European states have, apparently, in particular cases, acted to the contrary, in the IFTRA cases of the mid-1970s (involving virgin aluminum and glass containers), the Commission of the European Community explicitly repudiated the legality of private resolution of dumping disputes. Just as with our trade officials, and just as our trade law provides, the EEC Commissioners wanted trade dispute settlements open to the scrutiny of government officials responsive to Community-wide and not merely sectarian interests. This is, therefore, the norm in Europe too, even if sometimes honored only in the breach.

I also take issue with the conclusion that U.S. antitrust and trade law are in irreconcilable conflict. Antitrust law has always recognized that competition is not an absolute. There may be other valid and important goals such as reducing unemployment, protecting the environment and improving public service that may justify regulatory departures from competition. The trade law, like laws relating to energy, transportation and communications, reflects such an exception. It is not an irreconcilable conflict for antitrust law to apply beyond the scope of the antitrust exception set forth in the trade law. Rather, it is a division of jurisdiction, a division of responsibility largely without overlap, that is the situation today in the United States. (See the recent speech by Carl Cira, Assistant Chief, Foreign Commerce Section, Antitrust Division, Department of Justice "Possible Pitfalls in Joint Recourse to the Import Relief Laws or, Is That Antitrust?" [New York: World Trade Institute September 23, 1980]. See also a paper I delivered at the Practicing Law Institute in Washington on November 9, 1979 entitled "Antitrust Risks in Abusing the Import Relief Laws." The paper is available in Japanese translation from the offices of the U.S. International Communications Agency at the American Embassy in Tokyo.)

While, I realize, some Japanese industrialists have spoken in favor of such a proposal, other Japanese industrialists recognize that it would not be to their advantage. The most successful Japanese firms have more to gain from open U.S. markets in which there is aggressive competition, markets in which deals for the benefit of the competitive weak at the expense of the strong are discouraged. In the long run, it would be easier and less costly for Japanese firms to fight nonmeritorious complaints brought under existing U.S. trade law than to seek orderly marketing accommodations whenever such complaints are threatened. The excessive legalism and arbitrariness of the present trade law can frequently be turned, by experienced counsel, to the advantage of the importer. What protections of fair process the trade law does provide for the importer would be lost in an environment of free-for-all dealmaking.

For some of these reasons, and others as well, I am wary of the suggestion that an international convention should be negotiated to limit national (read "American") antitrust jurisdiction. We need more not less antitrust enforcement. As one prominent Japanese industrialist is reported by Kingman Brewster to have observed, "antitrust is the last best hope of the free enterprise system." It is particularly distressing to see the suggestion of less antitrust enforcement being made at a time when the idea of antitrust is taking hold in Japan.

For a variety of reasons beyond the scope of this paper it is in the national interests of both the United States and Japan that U.S. and Japanese antitrust agencies play an even more important role in the economic activities of their respective nations. It should continue to be a goal of U.S. antitrust enforcers to seek open access to American markets for Japanese imports on condition that those imports are marketed under the same rules of competitiveness and fair dealing required of domestic producers. Reciprocally, it should be a central commitment of the Japanese Fair Trade Commission to seek open access for American exports to Japan and for American owned enterprises in Japan in compliance with Japanese domestic law. The best answer to calls for greater U.S. protectionism is that U.S. exporters have achieved comparable access to the Japanese market as Japanese goods have here, and that departures from open access in one market can lead to retaliation in the other.

In sum, protectionism and antitrust law are not the central problems with current U.S. trade law and policy. The central problems are insufficient flexibility in the trade law to reflect, openly, public and national interest considerations in the disposition of dumping and subsidy cases, insufficient discretion for Executive branch and ITC officials to apply balanced decision-making in an area of great complexity, uncertainty as to the likely outcomes of the U.S. decision-making process, incomplete knowledge about the impacts of the rules we have fashioned, and too little, not too much compliance with antitrust law.

8/6/80... Additional Comments on a paper prepared by Carl Green for the U.S.-Japan Economic RElations Group entitled "Legal Protectionism in the United States and Its Impact on United States - Japan Economic Relations"

Here are offered a few summary observations and supplemental points, occasioned by the Sept. 17, 1980 meeting of attorneys.

The meeting succeeded in yielding a general consensus that the present regime of U.S. trade law, perhaps even more the law passed in 1974 than the law passed in 1979, is not perfect, could be improved, not realistically in the short run, but perhaps in the longer term, and that this is a worthy topic of further study. There seemed to be reasonable consensus that one of the problems with the present law is that it does not allow for dumping settlements on non-price terms. A second point of general agreement was that U.S. law failed to give sufficient discretion to the Executive Branch to settle dumping and countervail cases in the public interest, where such settlements were not viewed by the domestic complainants as adequate. There was agreement that Section 201 safeguard actions represented a fair model of how a trade law should operate in most instances, and a further consensus that there was an identity of interest between Japan and the U.S. in pressing for a new international safeguards code under the GATT. Speaking personally, it seems to me to be more in the joint interest of Japan and the U.S. that safequard orderly marketing agreements be publicly disclosed -- without exception ("transparent") than that they be eitehr selective or non-selective.

There was also agreement that any balanced assessment of U.S. "legal protectionism" calls for a precise assessment of legal barriers to U.S. exports to Japan and that such an assessment should be put on the agenda for follow-up work after the December Wise Men recommendations. Finally, there was a high degree of agreement -- though not consensus -- that U.S. trade law and policy probably puts an excessive premium on the quest for fairness to some, and insufficiently values predictability and efficiency. Accordingly, giving the Executive Branch greater discretion to resolve trade issues will be no improvement, if that discretion is exercised erratically. A few felt that International Trade Commission decisions since January have shown real promise as indications of reasonableness, rationality and extensive and competent explication, such as to increase predictability in the future.

One participant expressed the view that U.S. antitrust law does not let exporter-respondents settle trade cases. I substantially disagree. Individual exporters can, without question, settle and countervail dumping actions with the Commerce Department with no risk of antitrust liability. While the issue has never been ruled upon by the Justice Department, let alone a court, I think it is likely as well that groups of exporters can jointly settle trade actions brought by a group of domestic complainants. It is, of course true that private dumping and countervail settlements not reviewed by the Commerce Department to assure that they comport with the public interest, are subject to antitrust liability. Such was the clear intent of the Congress and is fully justifiable as a matter of law and policy.

Another participant made a valid point when he observed that there are discriminatory elements in the trade law that apply inequitably against importers. An example of such discrimination is the fact that American domestic manufacturers cannot be sued under existing U.S. law for dumping or "subsidies" violations in the U.S. market by U.S. importers who may be injured by these practices. Even if it were true, as I think it is not, that the Robinson-Patman Act (Act) were a close domestic analogue to the administrative dumping law, that Act provides a "meeting competition" defense which the Congress, and prior ITC commissioner have refused to provide to dumping respondents. However, two points ought to be noted. First, this criticism indicates how difficult it is to trade off fairness for predictability and efficiency. When you are the one suffering the unfairness it is often more important to you than the efficiency benefits conferred on others. Second, and a point that might be made in the Recommendations, is that the broader framework of U.S. commercial law itself -- for all its complexity, uncertainty, and multiplicity provides a means for resisting unwarranted use of the trade law.

One excellent example, which should be made know to a Japanese audience, is the dispute between the American firm Vishay, and the French firm Sferenice. These two high technology manufacturers of precision resistors are competitors in the U.S. market. Vishay had a dominant share of the product market and Sferenice was seeking to compete with it, exporting from France. As part of Vishay's effort to fight off Sferenice, it filed a Section 337 action. Sferenice countered by suing Vishay under, among other theories, an antitrust cause of action, alleging that Vishay was a monopolist exercising coercive monopoly power illegally obtained. Quite promptly, Sferenice was awarded an antitrust judgment of approximately $3,000,000. The Section 337 action was thereupon settled in a way which facilitates Sferenice's access to the U.S. market.

A second example of the way in which U.S. commercial law may be used advantageously by exporters is the considerable success the Japanese color TV manufacturers are having defending the antitrust suit brought almost 10 years ago by Zenith and National Union Electric. While it is too early to determine the final disposition of the litigation, the defendants have won a series of significant motions giving them a substantially stronger position in the litigation. Undoubtedly, using American legal process is expensive and time consuming for foreign firms, as it is for American domestic enterprises. But that is a cost of doing business in the U.S. comparable, perhaps, to the significant investment required by an American manufacturing enterprise seeking to compete effectively in the Japanese market.

One participant in the September 17 meeting stated that the administrative dumping law has the same pro-competitive purpose and effect as the antitrust laws. That position, I believe, is untenable. The administrative dumping law protects complaining competitors. The antitrust laws protect competition. This is nowhere better illustrated than by the fact that the domestic consumers of complainants' product, even other *industrial* consumers, will not be heard under the antidumping law to show why dumping relief would unduly injure *them* by unduly reducing competition among their suppliers. EEC dumping law, by contrast, and the dumping laws of Canada and Australia do take this into accoutn in injusry determinations. U.S. dumping law requires a weak standard of proof of causation for showing injury by importers. The antitrust laws require a strict standard of causation. The dumping law hinges on price discrimination as offensive. Antitrust enforcement is moving away from concern with price discrimination as an antitrust problem per se and many, if not most, antitrust experts have now concluded that competition would be pfomoted if the Robinson-Patman Act were repealed.

It is worth considering modifying the standard of the dumping law to be more like an antitrust statute -- more concerned with assuring competition than protecting existing market shares. That possibility was contemplated by some when the antidumping Act was passed in 1921. However, as that law has developed over the past 60 years, and especially as it is framed in the Trade Agreements Act of 1979, that possible interpretation has been virtually extinguished.

POLITICAL CONFLICT IN U. S.-JAPAN ECONOMIC RELATIONS:
WHERE IT COMES FROM; WHAT TO DO ABOUT IT

by

I. M. Destler
Carnegie Endowment for International Peace

and

Hideo Sato
Yale University

A Final Report to the Japan-United States Economic Relations Group,
November 1980

POLITICAL CONFLICT IN U. S.-JAPAN ECONOMIC RELATIONS:

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POLITICAL CONFLICT IN U. S.-JAPAN ECONOMIC RELATIONS: WHERE IT COMES FROM; WHAT TO DO ABOUT IT

I. SUMMARY REPORT

U. S.-Japanese economic relations are noisy. In Tokyo, bilateral trade disputes are regular front-page fare. In the United States the public pays much less attention to trade matters, but issues involving Japan are several times as prominent as trade relations with any other country.

Much of this drama is inevitable. Democracy breeds controversy, particularly over issues that matter. And trade often matters a great deal--to producers, workers, and consumers. With U. S. auto industry layoffs at 300,000, and Japanese car imports totalling $6.8 billion in value and 17 percent of the American market in volume, it would be a miracle if automobiles had not become an important political issue in the United States.

Some of the noise is also desirable. Dealing with changing economic realities requires frequent, sometimes painful policy adjustment in both Washington and Tokyo. Such change is unlikely without a healthy dose of political contention, within each country and sometimes between the two. Citizens in both need to understand that a certain amount of friction is normal, and learn to live with it. For policy conflict is often a necessary ingredient in the process of coping with and resolving bilateral issues.

Yet the frequency and intensity of U. S.-Japan trade conflict is deeply troubling. In 1969-71 bilateral economic relations were dominated by a bitter textile wrangle, over Japanese exports that totalled just four percent of her textile production, and one percent of U. S. textile consumption. In the 1977-80 period, there has been an epidemic of economic conflicts--over color television, steel, beef and citrus, telecommunications, automobiles, nuclear processing, macroeconomic policy coordination, and economic sanctions toward Iran.

Each of these became, at least for a time, a focus of strong controversy in at least one country, and each threatened to spill over to affect broader relations and policies. This is exactly what happened in 1971, when bitterness over textiles pervaded the Nixon White House, encouraging rebuffs to Tokyo on other issues and threatening Senate ratification of the Okinawa reversion treaty. There was no comparable breakdown of relations in 1977-80, though more than once it seemed possible, as when the stalemate over telecommunications procurement threatened to disrupt (at least in Japanese eyes) the May 1979 Carter-Ohira summit meeting. But the cumulative impact of recent disputes has been the impression of "unceasing acrimony," as Ambassador Nobuhiko Ushiba recently put it. (Ushiba, 2) And this, we are convinced, has been anything but healthy and desirable.

Persistent, high-visibility trade conflict generates bitterness in both countries: among Japanese against what they see as constant American pressure and self-righteousness; among Americans about what they perceive as Japanese relentlessness on exports and covert protectionism on imports. It can render particular issues enormously more difficult to resolve, as national positions become polarized and government leaders fear that compromise will be viewed, in the glare of publicity, as a sign of weakness. It fosters stereotypes--of the "unfairness" of Japanese trade practices or the "laziness" of American workers.

What can be done, then, to mute this pattern? How can the two countries achieve the "more constructive approach to Japan-United States economic relations" that President Carter and Prime Minister Ohira called for in May 1979? To help in understanding the roots of economic conflict and what might be done about it, we sought first to differentiate among types of issues. We then commissioned detailed case studies of five representative recent issues, each of which was investigated by both a Japanese and an American scholar. We summarize here our basic approach, the case studies, and our broader findings and conclusions.

A. 1977-80: FOUR TYPES OF ISSUES

Recent U. S.-Japan economic conflicts can be divided into four broad types, each with its distinct political pattern. The first, historically the most familiar, arises from the reaction of a U. S. industry to Japanese success in penetrating its market. The second begins with U. S. government efforts to secure relaxation or removal of specific Japanese import barriers. The third arises from broader U. S. concern with the overall trade imbalance, bilateral and worldwide, and resulting efforts to influence Japanese macroeconomic policies. The fourth comes from broader political concerns or global policies.

1. U. S. Imports from Japan

Rising imports in a particular product category cause a U.S. industry to seek protection or other U.S. government action. The executive branch seeks to respond at least partially to industry demands, because of the merits of the case, pressure from the Congress, a Presidential political commitment, or some other motivation.

If the competing U. S. and Japanese industries take strong, irreconcilable positions and their governments support them, the issue can prove extremely contentious, like the textile negotiations of 1969-71.

Recent issues under this general category include color televisions (and consumer electronics generally), steel, and automobiles. None of these led to major conflict between the two governments in 1977-80, but each generated strong pressures and spilled over into broader trade policies and relations. The steel and automobile cases were particularly important.

(a) Steel (by Hideo Sato and Michael Hodin)*

In 1977, the American steel industry was in visible difficulty--its domestic market showed no long-term growth trend, but imports were rising and export prospects were limited by world steel overcapacity and U. S. inability to compete on price. Moreover, Japanese steel sales in the U. S. had risen sharply in 1976, in response to the increased demand which recovery from the recession had generated.

The industry responded by mounting a campaign to restrict imports, one targeted particularly at Japan. Steelmen linked their trade problems to "unfair" practices of foreign firms and governments, particularly subsidies (though they lacked hard, current evidence of such practices in Japan) and sought relief under U. S. statutes combatting such practices. They particularly sought quantitative limits on imports, such as had existed under a U. S.-Japan-EEC voluntary restraint agreement in existence from 1969 through 1975. Specifically, the American Iron and Steel Institute (AISI) filed a formal complaint in October 1976, under a provision of the Trade Act of 1974 directed at "unjustifiable or unreasonable" foreign trade practices, charging that Japanese producers were diverting shipments from Europe to the United States. The Gilmore Steel Corporation, a small Oregon firm, followed in February 1977 with an anti-dumping suit against five major Japanese steelmakers. In the meantime, U. S. industry and labor counterparts were urging on Japanese counterparts the conclusion of an orderly marketing agreements limiting their sales to the U. S. market.

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*For their full analysis, see Background Paper A.

Increasingly, the industry worked with Congressional allies to pressure the Carter Administration to take action against imports. And the Administration could not ignore such pressure, for it was engaged in pushing the multilateral trade negotiations (MTN) to completion. The MTN agreements would require congressional approval, and this would be difficult to attain if a major industry like steel stood in opposition.

Japanese steelmakers thought the AISI emphasis on "unfair" trade practices was basically unfounded, at least insofar as they were concerned. They prided themselves on their modern, efficient, internationally competitive plants. But while they abhorred the charges and the legal actions, they took the campaign as evidence of the U. S. industry's seriousness in seeking import controls. And the major Japanese firms were quite willing to contemplate an intergovernmental orderly marketing agreement. Unlike their counterparts in textiles, electronics and many other industries, steel leaders had been extremely sensitive to U. S. criticisms for a variety of reasons, which included their indebtedness to the United States for postwar assistance as well as their fear of losing their large U. S. market share. Indeed, Yoshihiro Inayama of Nippon Steel, head of the Japan Iron and Steel Federation (JISF), was known as "Mr. Cartel" for his emphasis on the need for export restraint.

Officials at the Ministry of International Trade and Industry (MITI) were sympathetic to the JISF view that an orderly marketing agreement was desirable; they saw the initiation of negotiations, however, as up to the United States, and they found the Carter Administration extremely reluctant to take this course. It had just negotiated an OMA with Japan for color televisions, and one with Korea and Taiwan on shoes, and had no wish for more such agreements. Moreover, it saw quantitative restrictions as an invitation to the U. S. industry to raise its prices, exacerbating inflation. Thus the Administration took no action as the issue heated up through the spring, summer, and early fall. Industry charges of Japanese "unfairness," meanwhile, were highlighted in the Japanese press, generating considerable resentment.

Finally, the U. S. steel industry forced the issue by generating what some called a "firestorm" on Capitol Hill. In September steel caucuses were formed of Senators and Representatives from producing states; the combination of their pressure and plant closings generated front-page attention. The campaign received further impetus when the Treasury Department made a preliminary determination in favor of the Gilmore suit, at least partly because, arguing operational confidentiality, the Japanese firms declined to supply cost-of-production data the Treasury needed to enforce the U. S. law. President Carter responded by forming an interagency task force headed by Under Secretary of the

Treasury Anthony Solomon, who would provide the strong leadership on this issue that the government had previously lacked. Then, on October 13, Carter met with industry and labor leaders and promised vigorous pursuit of anti-dumping investigations (by now, U. S. Steel had filed a suit of its own). In exchange, the industry dropped its call for quotas.

Solution through the U. S. anti-dumping laws was anathema to the Japanese, who argued that these laws themselves were unfair in how they defined dumping. Europeans were, if anything, even less receptive to this approach. Over the next month, in consultation with Europeans and Japanese, the Solomon Task Force worked out an alternative, an innovative "trigger price mechanism" (TPM), to be enforced unilaterally by the United States but with foreign cooperation. Minimum import prices would be set for different categories of steel, based on the costs of the world's most efficient producers--the Japanese. If products entered the United States at prices below these, the Treasury would itself initiate an anti-dumping investigation. In the meantime, however, industry anti-dumping suits would be withdrawn.

In short-run political terms, the TPM was a striking success. The U. S. industry got some protection; the Japanese industry got an orderly U. S. import regime plus official recognition of its role as world pacesetter, though the TPM itself discriminated in favor of less efficient producers, particularly in the EC, and the Japanese share of the U. S. market was to decline significantly in 1978. The United States government got both a quieting of the political storm and some de facto control over steel prices. And when the MTN came before the Congress in 1979, steel senators and representatives voted in favor.

(b) Automobiles (by Gilbert Winham and Ikuo Kabashima)*

In the 1970s, U. S. automobile imports doubled, rising from 1.26 million in 1970 to 2.32 million in 1979. The Japanese share of these imports tripled, as Japan's automakers--who had sold mainly to domestic buyers in the sixties--move aggressively onto the world stage. For most of the decade, the political response of U. S. automakers and labor was muted. The companies' main earnings were from sales of large cars at home and from plants overseas, neither directly threatened by small car imports. The United Auto Workers, the most liberal of America's large unions, did express growing concern, but sought mainly to persuade Japanese companies to open plants in the United States. Thus, despite their central importance to both national economies, automobiles did not figure prominently in either the substance of the MTN agreements or the politics of their ratification by the U. S. Congress.

But as the decade ended, an "automobile crisis" suddenly emerged. Revolution in Iran triggered a round of oil price increases by OPEC countries, driving American gasoline prices higher and bringing temporary but well-publicized shortages and gasoline lines. What had been a gradual shift toward small cars in consumer preferences was suddenly accelerated, and U. S. automakers were unready to meet this demand. Recession compounded their problems, as did the spreading view that U.S.-built cars were inferior in quality to Japanese imports. Chrysler was saved from immediate bankruptcy by special government loan guarantees; Ford and General Motors also suffered record losses, and industry employment dropped by 29 percent.

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*For their full analyses, see Background Papers B and C.

By early 1980, automobiles had become the most important trade issue facing the Carter Administration, and the hottest U.S.-Japan issue. In February, UAW President Douglas Fraser, frustrated by the limited success of previous calls for Japanese investment, made a well-publicized trip to Japan where he argued not only for Toyota and Nissan to build plants in the United States (Honda had already announced plans to do so), but for restraint in Japanese car exports to the American market. Then and subsequently, MITI leaders sought to persuade Toyota and Nissan to invest, with only limited success. They also moved reluctantly to the view that some form of export restraint might be necessary, but they hesitated to act without American initiative. Without official U. S. participation in import restraints, the Japanese might be vulnerable to action under American anti-trust laws barring "restraint of trade." Moreover, MITI needed a formal U. S. request as leverage with the auto companies, who were reluctant to restrain exports--partly because of intense competition among them. And MITI's power over them was limited.

The immediate American response to UAW pressure was stated in March Congressional testimony by U. S. Trade Representative Reubin Askew--opposition to quotas, but strong support of Japanese investment. As the issue heated up, it became intertwined with the electoral campaign, with President Carter in urgent need of UAW support. Divisions within the U. S. government grew, with Transportation Secretary Neil Goldschmidt supporting quotas and USTR unable to establish clear primacy on the issue. The two governments did negotiate some further liberalization of Japanese auto import policies, such as eliminating tariffs on auto parts (automobile tariffs, as high as 50 percent in 1967, had already become zero in 1978) and making it easier for U. S. manufacturers to meet Japanese product standards. In the critical U. S. market, however, the action was forced on June 12 when the UAW petitioned the U. S. International Trade Commission for relief under the "escape clause" provision of American trade law, claiming that imports caused "serious injury" to the industry and urging sharp, temporary import cutbacks to provide relief. The Ford Motor Company joined in the petition.

By this time, the automobile issue had become one of the most visible U. S.-Japan trade issues of the postwar period. Pressure from Congressional sources increased, though it took the form of hearings and general resolutions aimed at influencing the U. S. administration--and the Japanese--rather than legislating a statutory solution. President Carter, after a thorough interagency review, stopped in Detroit (en route to Prime Minister Ohira's funeral) to announce a $1 billion relief program for the auto industry, grandly packaged as the beginning of a "close-knit, permanent partnership" between Washington and Detroit as part of a broad new industrial policy. He also urged the ITC to expedite its investigation of the UAW petition--the Commission did so, but less than Carter asked, deciding to make its findings after, not before, the fall election.

On November 10, the ITC found against the UAW and Ford by a 3-2 vote. All commissioners concluded that the auto industry had suffered injury, but the majority found imports less important as a cause than recession high interest rates, and the shift in the consumer demand from large to small cars. Thus, under the law, they could not recommend import restrictions. Ther was, however, evidence of restraint by the Japanese automakers in their sales to the U.S. market in the second half of 1980.

In fact, MITI Minister Rokusuke Tanaka explicitly forecasted, on September 17, a decline in auto sales to the U.S. in the coming months, a statement immediately and favorably acknowledged by President Carter. If U.S. auto sales recovered sharply as new , fuel-efficient models reached the market, it seemed possible that protectionist pressures would fade. If sales of U.S.-made cars continued slow, however, such pressures would likely persist.

But a longer-run problem remained. For American and Japanese automakers had approached the world market in opposite ways. General Motors and Ford invested widely overseas and produced there; Toyotas and Datsuns were "made in Japan" and exported. However the 1980 crisis was specifically resolved, it suggested enduring political limits to the Japanese firms' approach--their overseas sales were vulnerable in a way that sales of cars produced overseas by U. S. multinational firms were not. In the short-run, major curtailment of Japanese car exports to the U. S. seemed unlikely. But the Japanese firms were under increasing, perhaps irreversible pressure to manufacture in America. For the U. S. government, interest in such investment began because it seemed a short-run expedient: the UAW wanted it, and thus it might be a politically viable "solution" averting unwanted trade restrictions. From a longer-term perspective, however, such investment would serve three major U. S. policy goals: increasing employment, protecting U. S.-Japanese relations, and accelerating the shift of American consumers to small, energy-efficient cars.

(c) Comparative Analysis

On both steel and automobiles, the positions of the two governments were broadly similar. Neither wanted import quotas imposed by the United States. Both wanted to mute the conflict, to find a workable compromise so that the problem would not become unmanageable politically. Nor were industry positions in the two countries as diametrically opposed as one might have guessed, given their interests. On steel, the Japanese and American industries both favored an orderly marketing agreement. On automobiles, there was no similar consensus, but the difference *within* each nation's industry seemed as great as that between them. The UAW had moved, by 1980, to strong advocacy of quotas, but General Motors continued a basically liberal position, with Chrysler and Ford in between. In Japan, Toyota and Nissan were less ready than Honda to invest in passenger car production in the United States, but more willing to restrain exports.

Thus on each issue, the political climate appears to have been reasonably favorable for one obvious means of resolution--some form of Japanese export restraint. But the U. S. government was inhibited from initiating such action. Washington's reticence had three main sources: free-trade conviction (reluctance to bring another industry under quota arrangements); domestic economic concern (over the inflationary impact of quotas); and legal impediments (it lacked clear authority to negotiate limits without an ITC injury finding, and any restrictive arrangement would be subject to anti-trust litigation). Moreover, it saw steel as an economic and trade policy problem, not a U. S.-Japanese relations problem--and for the most part, U. S. officials viewed automobiles the same way.

In Tokyo, MITI was prepared to support export restraint on steel if the U. S. government seriously wanted it. Otherwise, MITI did not want to set a precedent--of appearing too willing--which might encourage OMAs in other product areas also. On automobiles, MITI's effort to achieve voluntary industry restraint was made harder by a lack of a clear U. S. request. Thus, while each issue heated up, the two governments consulted but did not enter serious negotiations. On steel, a workable resolution was reached in the end, and one may be on automobiles also. But in the process each became a political event of major proportions, as demonstrated by the Congressional "steel firestorm" on September 1977 and the unprecedented visibility of automobile issue through 1980.

Would earlier Japanese initiative have brought earlier resolution? The steel industry did offer export restraint, responding to signals from U. S. counterparts, but the U. S. government rejected it. The Treasury's finding of dumping in the Gilmore suit might conceivably have been averted if MITI had proposed that the steelmakers make cost of production data available in the modified form ultimately provided for the TPM. But in general, there was no way for Japan to speed resolution until the U. S. government was persuaded if its urgency, and only steel industry pressure could accomplish this. The auto case seems different. Auto manufacturers could have responded several years earlier, and much more substantially, to pressures that they invest in the United States, as Volkswagen had done. Their reluctance to move to multinationally-based manufacturing was unique among the world's major motor vehicle producers, and rendered them particularly vulnerable politically.

In the United States, strong policy leadership might have brought quieter and/or quicker resolution, but STR proved relatively weak on both issues. In 1977, though Robert Strauss was moving into a predominant trade leadership position, he did not take charge of steel--instead the political firestorm and the initial focus on dumping led to adroit adjudication by Under Secretary of the Treasury Anthony Solomon, but only *after* the heat. STR was preoccupied with MTN issues until mid-1979 and engaged in a major reorganization and leadership turnover thereafter; it did not, therefore, get seriously into the auto question until early 1980, and even then U. S. Trade Representative Reubin Askew had difficulty establishing his ascendancy over other administration voices such as Secretary of Transportation Neil Goldschmidt.

2. U.S. Exports to Japan

A second pattern of conflict, particularly evident in recent years, has come from U. S. efforts to expand the Japanese market for products where American producers believe they have significant comparative advantage. Typically, this kind of issue initially comes to prominence not from the pressure of an industry seeking a future gain, but from U. S. executive branch officials--usually in the context of a broader negotiation like the MTN. At first the issue may be raised quietly, with U.S. officials dissatisfied with the Japanese response. Thereafter the pressure becomes stronger and more public, with U.S. interest groups and Congressional allies joining in the campaign with executive branch encouragement (and sometimes orchestration).

In the 1977-80 period, the primary issues falling into this category were agricultural commodities and high-technology manufactured goods. Particularly important cases included Japanese imports of beef and citrus products, and the U. S. demand that the procurement of Japan's public corporation, Nippon Telephone and Telegraph (NTT), be opened up to non-Japanese firms.

(a) Agriculture (by Hideo Sato and Timothy Curran)*

The agricultural trade issue of 1977-78, which particularly concerned beef and citrus, arose in the context of the MTN and an enormous bilateral trade imbalance. While beef and citrus involved only a tiny fraction of the total bilateral trade, the United States focused on the Japanese import quotas on these products, which came to be seen as "symbols" of the closed Japanese market; beef and oranges represented two of the 27 residual import quotas Japan still maintained against GATT rules. (The negotiations did not address U. S. beef import quotas, or disease control regulations barring the import of Japanese mandarin oranges to all but six U. S. states.)

At first, beef and citrus were simply mentioned by U. S. officials among possible import liberalization items for consideration by the Japanese government. Failing to obtain sufficient Japanese response to this and other proposals, the United States intensified its pressure in the late fall of 1977, starting with the trade mission headed by STR General Counsel Richard Rivers in November.

Japanese strongly resisted the demand for full import liberalization. Japanese farmers enjoy considerable political power because of their close association with the ruling LDP and a skewed electoral district system which favors rural areas. They are also effectively organized under the name of Nokyo (Agricultural Cooperative Association). Moreover, Japanese citrus growers faced a serious problem of overproduction, and beef cattle farmers were still recovering from the damage they had suffered in 1973-74, when the doubling of beef imports was followed by a drastic reduction of domestic demand in the wake of the OPEC oil embargo. But under strong U. S. pressure, Agriculture Minister Ichiro Nakagawa acceded to discussions of incremental import expansion.

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*For their full analysis, see Background Paper D.

In January 1978, an agreement was reached as part of broader negotiations between STR Robert Strauss and Minister for External Economic Affairs Nobuhiko Ushiba. Japan consented to a three-fold increase in its annual import quota for fresh oranges, a four-fold increase in its citrus-juice quota, and a three-fold increase in the hotel beef quota.

This Strauss-Ushiba agreement did not end the issue, however. Instead, it whetted the appetite of U.S. domestic producers for Japanese concessions. Believing that the issue had been settled once and for all, Japanese producers mounted emotional resistance to renewed U. S. pressure for liberalization of Japanese beef and citrus imports in the spring and summer of 1978.

In July the United States agreed to shelve its demand for full liberalization and suggested specific trade expansion figures. Japanese officials thought that this U. S. compromise offer might lead to prompt settlement. But the Nakagawa-Strauss talks in September proved otherwise. A press leak about the July concession alarmed U. S. producers who had been kept in the dark about it. Moreover, charges of alleged "profiteering" and "scandal" among privileged Japanese fruit importers circulated among American citrus growers, strengthening their determination to press for maximum concessions from Tokyo. So Strauss, needing to respond to competing demands from Florida and California orange-growers, toughened the U. S. position, to the surprise and disappointment of Japanese officials. Another series of talks ensued at both political and working levels, and it was not until mid-November that MAFF Economic Affairs Bureau Director Nobuo Imamura and Deputy STR Alonzo McDonald arrived at a tentative agreement formula in the course of their Geneva talks.

In early December Ministers Nakagawa and Ushiba met in Tokyo with Ambassador Mike Mansfield and Deputy STR Alan Wolff with a view to concluding the issue. There Wolff made one more attempt to get the Japanese to discuss a timetable for liberalization--but to no avail. The two sides concluded the talks--basically along the line of the Imamura-McDonald formula--on December 5, just hours before Prime Minister Takeo Fukuda and his Cabinet stepped down as a result of Fukuda's unexpected loss to Masayoshi Ohira in the party primary election. According to the agreement, Japan's annual importation of fresh oranges, orange juice, and high quality beef would be by 1983 roughly double the amounts promised in the Strauss-Ushiba agreement in January, with the understanding that post-1983 trade expansion would be a subject of future intergovernmental discussion.

Japanese beef and citrus producers acquiesced in the settlement between the two governments, and U. S. producers, basically happy with the results, subsequently endorsed the MTN package.

(b) Nippon Telephone and Telegraph (NTT) Procurement (by Timothy J. Curran)*

During the MTN negotiations for a code on government procurement, the United States requested that Japan place purchases by its state-owned public corporations, including Nippon Telephone and Telegraph Company (NTT), under the code's open bidding procedures, allowing foreign firms to compete for that business. The Japanese resisted the American request, arguing that most telephone systems follow closed procurement practices similar to Japan's. Detailed and complex negotiations throughout late 1978 and early 1979 failed to bring a solution. As the dispute festered, it became entangled with preparations for summit meetings to be held in May and June, 1979. Many feared it would spark a major confrontation when a highly publicized series of negotiations collapsed in March and April.

The NTT confrontation began in Geneva. In the summer of 1978, the United States offered to open about $16 billion of its government contracts to open bidding, while the EC offered about $10.5 billion and the Japanese about $3.5 billion. Arguing that this Japanese offer was disproportionately low, the U. S. officials requested that Japan add to it the purchases of its three public corporations. Of these NTT was the largest, with procurement totalling $3 billion. At this point, American interest focused on NTT because of the amount of the company's purchases, not because of their high-technology content.

The Japanese were unable to comply. NTT used a closed, negotiated system of procurement, making 97 percent of its purchases from a small "family" of Japanese suppliers. But contrary to the initial assumption of U. S. government officials, the central government in Japan did not exercise direct control over the public corporations, particularly

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*For his full analysis, which draws on an analysis by Yasushi Hara, see Background Paper E.

NTT, which had developed a number of formal and informal means to insulate itself from central authority. NTT was determined to resist open procurement in order to protect relationships with local suppliers and prevent the possible leakage of high-technology secrets. Its power to resist was increased when the job of pressing for industry concessions was given to the Ministry of Foreign Affairs, which lacked expertise and credibility in this area of policy.

As the NTT stalemate continued, the issue became intertwined with broader U. S. criticism of Japan's trade practices. Two groups in particular, the Commerce staff supporting the U. S.-Japan Trade Facilitation Committee and the Task Force on U. S.-Japan Trade of the House Ways and Means Committee, focused on NTT's restrictive buying practices. In November 1978, three Task Force members visiting Tokyo called at NTT headquarters to request greater access to its high technology procurement. The meeting was unproductive, and the American representatives returned to the U. S. angry at what they saw NTT's extreme inflexibility. They began to call NTT a "symbol" of Japan's "closed market." In their widely publicized report of January 1979, issued in both Japan and the United States, they labelled NTT procurement policies "one of the sorest points in our bilateral trade." Citing the overall imbalance in telecommunications trade, they added: "Since telecommunications is one of the industries 'of the future,' this type of one-sided and unfair trade competition is particularly serious." (Ways and Means Committee, p. 33)

As negotiations continued in 1979, U. S. negotiators increasingly stressed the techological importance of this issue--the focus broadened from the amount of NTT's purchases to emphasize the content of those purchases. But Americans did not specify which particular high technology goods they most wished NTT to open to competitive bidding, though they felt their general emphasis was clear. This lack of specificity weakened the hand of the Ohira government in Tokyo, which had begun belated but very determined efforts to pressure NTT into making some concessions to American demands.

Tension increased as the NTT negotiations became entangled with the approaching bilateral and multilateral summit meetings. The most serious clashes took place on the eve of the May 1979 Carter-Ohira meeting in Washington, when Japanese offers, containing increased access to NTT's contracts but still lacking certain high technology items, were rejected by American trade officials, resulting in a widely-publicized stalemate. With just hours to spare before the start of the bilateral summit, a procedural solution was reached which set a common negotiating objective and postponed future negotiations until after the summit. In June 1979, Robert Strauss and Nobuhiko Ushiba signed an interim agreement on NTT, in which the two countries agreed to negotiate for a settlement by December 31, 1980 on the basis of "mutual reciprocity . . . in access opportunities to each other's markets." The United States, in the meantime, indicated that it would deny Japanese firms access to U. S. contracts under the MTN government procurement code unless a satisfactory deal on NTT was achieved.

As of November 1, 1980 the two governments were negotiating on the basis of a three tier formula which would open bidding procedures to varying degrees depending on the level of technological sophistication. Foreign firms were to have access, however, to contracts in all three tiers.

(c) Comparative Analysis

Unlike steel and automobiles, both agriculture and NTT were mall issues in terms of the amount of current trade affected, but they ad long-term significance. Both were pressed by a U. S. government which avored trade expanding solutions to bilateral and global trade imbalances. nd both became major political issues in Japan, with a volatile mix of omestic contention and highly visible U. S. pressure. In the United tates, they were far less visible than automobiles and steel, since they lacked onnections to current unemployment. But for Americans concerned with rade policy, they were the type of issues where Japan appeared culpable, nd each came--for a time--to symbolize the "closed nature" of the Japanese arket.

In each, Japanese political leaders and trade negotiators ere inclined to meet U. S. demands at least part way, but they faced etermined interests with considerable capacity to resist. Credible and ersistent U. S. pressure was important in countering this resistance, in aking policy change possible, and change-seekers within Japan sometimes ncouraged U. S. pressure. Each issue became more volatile, however, when t became linked to a broader bilateral trade crisis.

In the beef and citrus case, this linkage was more or less lanned. Agricultural quota liberalization was included in the broad rogram of policy changes which Americans, encouraged by Japanese counterarts, put forward in the fall of 1977, with the hope of reaching a broad reakthrough on trade matters. And of the issues addressed in the Strauss-shiba statement of January 1978, agriculture was the most intractable.

On NTT, linkage was initially accidental--the issue arose late in the MTN, and its negotiating timetable coincided with preparations for the May Ohira-Carter summit conference. Once this "linkage" arose, U. S. trade negotiators did exploit it tactically to win concessions, but they acquiesced in the eleventh hour, White House-led move to put NTT on a separate track once it was clear that a pre-summit resolution was impossible. Japanese, more sensitive to the political and symbolic cost of a soiled summit, tended to perceive the linkage of NTT as deliberate and calculated by U. S. officials, and the "threat," amplified by the Tokyo media, generated broad resentment.

In both cases, "linkage"--deliberate or accidental--proved at most only a step toward resolution. The agriculture talks continued until the end of 1978, eleven months after the Strauss-Ushiba statement. The May 1979 summit yielded only an "agreement to agree" on NTT by the end of 1980.

In each case, resolution was complicated by the uncertainty of the U. S. bargaining position. STR Strauss, needing to balance the demands of competing groups, was deliberately ambiguous about what the U.S. would ultimately accept, and introduced what the Japanese saw as new demands late in both negotiations. This made it harder for Japanese negotiators to mobilize the needed consensus.

Both issues were, however, handled without major crisis. On agriculture, a major reason was that U. S. decision-making was well-orchestrated under Strauss and sent consistently "tough" signals--it became clear that the United States was not bluffing, that some concessions would be necessary even though the precise American demands were not clear.

In Tokyo, Nakagawa and Ushiba exercised effective leadership, capitalizing on the somewhat isolated position of agricultural interests in Japanese society, building domestic consensus for concessions while simultaneously getting the United States to modify its demands.

On NTT, resolution was complicated by the peculiar nature of NTT--its autonomous position within the Japanese government, and the technical, "insular" overlook of its leading officials. Government leaders had limited jurisdiction over them and were unaccustomed to dealing with them. And the U. S. position seemed to grow progressively tougher--beginning with the volume of NTT purchases open to international bidding; ending with the high-technology content of these purchases. Nevertheless, adroit eleventh-hour diplomacy averted the open summit break which neither the Carter White House nor the Ohira government desired. And while their agreement did not resolve the issue, it did place it on a more reasonable, quid-pro-quo basis, with U. S. access to Japanese government procurement being bargained against Japanese access to U. S. official purchases.

3. The Trade Imbalance and Japanese Growth Policy

Specific trade negotiations in 1977 and 1978 took place in the context of an unprecedented overall trade imbalance. The bilateral deficit in Japan's favor grew from $5.4 billion in 1976 to $8 billion in 1977 and $11.6 billion in 1978--each figure setting a record. Worldwide, Japan's current account surplus increased from $3.7 to $10.9 to $16.5 billion over this same period, and U.S. trade worldwide was in record deficit.

To cope with these problems, U. S. officials sought not only removal of Japanese import barriers but changes in Japanese macroeconomic policies which they considered partially responsible for the imbalance.

(a) Macrodiplomacy (by I. M. Destler and Hisao Mitsuyu)*

The Japanese surplus of 1977-78 had its roots in the inflationary explosion earlier in the decade. Spurred by a combination of expansionist economic policies and the OPEC "oil shock" of 1973-74, Japan's consumer price index for 1974 jumped 24.3 percent over the previous year, and the wholesale price index rose 31.4 percent. Senior LDP leader Tak Fukuda was installed as government economic czar to combat this inflation. He maintained very tight monetary and fiscal policies through the end of 1975, more than a year after the onset of worldwide recession, and price stability was restored. The wholesale price index, for example, rose by only 1.9 percent in Japan fiscal year 1975 (April 1975 - March 1976), and 5.5 percent in JFY 1976.

A side effect of these policies was to delay Japan's recovery from recession. And when it came it was led by exports, resulting in a substantial current account surplus--$4.7 billion in JFY 1976. When Fukuda became Prime Minister in December 1976, he declared his intention to right this balance by strengthening domestic demand, and his JFY 1977 budget called for expanded public works spending. But Japanese private economists questioned whether investment and consumer spending would grow enough to make the key targets attainable: 7 percent economic growth, and a current account deficit of $700 million.

American recovery from the recession had, by contrast, been relatively rapid, and Carter administration economic officials came to power determined to accelerate it further. To promote international balance, they pressed the "locomotive" thesis: that the three "strong" advanced industrial economies (West Germany, Japan, the United States) should stimulate demand and draw in imports, pulling the weaker economies along. Vice President Walter Mondale sounded this theme in his post-inauguration trip to Europe and Japan. The U. S. and its allies, the U. K. in particular, continued to urge stronger Japanese (and German) growth at the London economic summit of May and at OECD and IMF meetings that summer and early fall. They also pressed the Ministry of Finance and the Bank of Japan not to prevent the yen's value from rising. (Americans were convinced they had done so in 1976 by intervening heavily in foreign exchange markets.) And the yen did move sharply upward in 1977--from 289 in January to 277 in April, 266 in July, and 240 by year's end.

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*For their full analysis, see Background Paper F.

But Japan's growth rate lagged and the surplus, contrary to government projections, was rapidly rising. Americans increasingly saw this surplus as a major international problem (Japan as a drag on world economic recovery) which threatened to become, in combination with specific trade disputes and the growing U. S. deficit, an American political problem. When State and Treasury officials raised the issue at sub-Cabinet bilateral talks in September, their Japanese counterparts neither challenged the U. S. definition of the problem nor took clear action to address it.

The rise of the yen, however, was fueling discontent with Fukuda's economic policies in the Japanese business community. So the U. S. turned up the pressure, encouraged by Japanese who saw external pressure as useful in their internal economic policy struggle. MITI officials in particular were expansionist-minded, while Finance people adamantly resisted. In late November a U. S. mission presented a number of specific trade and economic policy demands--including a 7 to 8 percent growth target for JFY 1978--and its visibility and pressure were magnified by the Tokyo media. In subsequent weeks, Fukuda reshuffled his Cabinet to put expansionists in key positions, and his government adopted the 7 percent growth target, with record deficit spending planned to achieve it. The growth target was incorporated in the Strauss-Ushiba Joint Statement of January 1978; so was a prediction, which some Americans read as a promise, of "marked dimunition" of the current account surplus.

The statement calmed the political waters, but despite the new Japanese policy goals, growth lagged and the surplus grew. It reached $14 billion for JFY 1977, and figures for the spring and summer indicated it might be even larger in 1978. At the Bonn summit of July 1978, the U. S. won a reiteration of the growth target (paired with a similar German pledge), and a Fukuda promise to adopt a supplementary stimulus package if needed. One was adopted in September. Meanwhile, the United States was bowing out as a locomotive. Inflation was accelerating well beyond U. S. government predictions, the dollar was plummeting, and Carter promised at Bonn to combat inflation and to pursue an effective energy policy. This was followed by a major "dollar defense" initiative in November: a sharp tightening of U. S. monetary policy and an international program of exchange market intervention in which Japan was a major participant.

In December 1978, Masayoshi Ohira upset Fukuda in the LDP presidential "primary." In his first press conference as Prime Minister, he announced that Japan was abandoning the 7 percent growth target as unreachable.

ashington reaction was sharp. Officials were frustrated by the persisent Japanese surplus, exhausted by a series of difficult bilateral trade egotiations, and worried about Congressional action on the MTN in 1979, arter dispatched a strongly critical letter to Fukuda, which was read (probably incorrectly) as a threat he might not attend the Tokyo economic ummit scheduled for June 1979. Japanese who saw the letter were, in urn, shocked and angered by it.

Fortunately, both sides then moved away from confrontation. group of U. S. economic forecasters visited Tokyo in January and concluded that, unlike previous years' Japanese government current account projections, the one for JFY 1979 (anticipating marked improvement) was plausible. And Japan's current account balance did, at long last, move rapidly from surplus to deficit. By the May 1979 bilateral summit, it was possible to put national macroeconomic policy commitments in more general, reciprocal form. Both the Japanese surplus and the U. S. deficit were "not appropriate," but there had been "significant reduction" of both "in recent months." Japan would foster domestically-led growth and continue to open up her markets; the U. S. would reduce inflation, restrain oil imports, and promote exports. The period of visible macroeconomic policy conflict was over.

(b) Analysis

In terms of policy results, the American drive to influence Japanese macroeconomic policy was at least a limited success. The JFY 1978 growth target was higher than it likely would have been otherwise; government economic stimulus was probably larger; the Japanese economy did in fact shift from the export-led growth of 1976-77 to domestically-led growth by 1979. And the current account surplus did disappear in 1979, though the main cause, most experts felt, was not increased government stimulus but yen revaluation (and later the jump in oil prices).

The source of the U. S. initiative was the policy convictions of members of the U. S. executive branch. One major reason for its Tokyo impact was that, in the fall of 1977, the Japanese government and business community were deeply divided over the wisdom of Fukuda's conservative economic policies. And businessmen were frightened by the impact of the yen's rise on their exports. With the normally dominant Ministry of Finance resisting change, officials at MITI and the Foreign Ministry encouraged American pressure and used it in their internal struggle. Since the government's growth and current account projections were proving wildly optimistic, critics could seize on the obvious need for policy adjustment and were able, in part, to prevail.

But the key ministries--Finance and Treasury--were either opposed or on the sidelines. Thus the growth initiative did not lead to improved consultation between established policy institutions (as the November 1978 "dollar defense" initiative would on monetary matters). Moreover, broad Japanese resentment of U. S. pressure, of being victimized by it, outlasted the fall and winter of 1977-78; indeed, in some respects it increased as the failures in *U. S.* macroeconomic management became more evident. Thus Carter's December 1978 letter to Ohira was broadly resented, and while it did demonstrate that the Administration *cared* about both the form and substance of Japan's international growth commitments, its reception made it clear that *internationally negotiated, publicized commitments to specific policy targets* were a burden that

Japanese politicians and bureaucrats no longer wished to bear. The 1979 summit communique acknowledged this limit and skillfully made it a virtue. Bilateral talks would henceforth focus on "basic policies," with "specific actions" to be, as of old, "the national responsibility of each government."

The U. S. negotiating initiatives on growth were clearly right in the assumption that international imbalances could not be effectively addressed by trade bargaining alone, and right also in their recognition that national economic policies have important international impacts. But frustrated by slow progress, encouraged by Japanese allies to be more specific, Americans ended up intruding too deeply and visibly in Japan's domestic process. And their inevitable focus on numerical targets, on outcomes beyond the power of governments to control, fed exaggerated notions of what such negotiations could accomplish, followed by dissappointment when the numbers ended up different from those projected.

4. Bilateral Economic Conflicts over Political-Strategic Issues. A fourth form of conflict is that which arises between national economic policies and the political-strategic policies of at least one country--usually the United States. The United States asks that Japan, as an ally, curtail certain economic transactions or put them at risk; Japan sees serious economic costs if it complies. An historical example was American concern in the fifties about Japanese trade with the Peoples Republic of China. More recently, Japan's deep concern about energy security have repeatedly been in tension with other U. S. policy objectives--in 1973, when Japan's diplomatic "tilt" in the Arab-Israeli conflict complicated Kissinger's effort to inaugurate peace talks (Nau, forthcoming); in 1977, when Japanese

plans to undertake experimental nuclear reprocessing at the Tokai Mura plant came up against President Carter's non-proliferation policy; and most dramatically in December 1979, when expanded Japanese economic relations with Iran appeared to undercut U. S. efforts to get its hostages back home.

This latter case posed particular dangers for bilateral relations, for here the attentive audience was the entire U. S. public, hearing an official Administration denunciation of the Japanese for "rushing" to buy Iranian oil after the U. S. halted its purchases, and Japanese banks for "going overboard" to help Iran cope with the U. S. freeze of its assets. Fortunately, the issue quickly faded, with American officials embarrassed by the way it had surfaced and Japanese by how their oil purchases appeared. But its sources seemed all too typical--U. S. failure to communicate in advance, in any consistent manner, what it expected of its allies in this situation; Japanese inability, in the absence of a clear signal, to read the American scene and make reasonable adjustment to it. The latter in turn was the product, in part, of decentralized Japanese decisionmaking on oil purchases. But when the loud denunciation was followed in subsequent months by scrupulous Japanese cooperation on this issue--and on opposition to the Soviet invasion of Afghanistan--this reinforced the widespread U. S. view that heavy pressure was the most effective way of dealing with Japan.

B. COPING WITH FUTURE CONFLICTS: FINDINGS AND RECOMMENDATIONS

The U. S.-Japan economic conflicts of 1977-80 were colored by two particularly important events. The first was the climax of the multilateral trade negotiations. The second was the emergence of a record bilateral trade gap, accompanied until early 1979 by an unprecedentedly large Japanese current account surplus (and a parallel American trade deficit).

The ongoing MTN talks provided the specific context for the agriculture and NTT negotiations, influencing the timing and content of U. S. initiatives and setting the deadlines for reaching agreement. More generally, the need for Congressional ratification of the MTN made the U. S. executive branch necessarily responsive to industry interests on these issues, as well as on steel.

The overall trade imbalance had both direct and indirect effects. It was a major impetus for U. S. agriculture and NTT proposals, and Japan's surplus was the overriding reason for U. S. pressure on macroeconomic policy. On steel and automobiles, the trade gap was used by U. S. industry and labor to buttress their cases for import restrictions. The trade gap also had important indirect impact by creating, in U. S. trade politics, something of a "presumption of Japanese guilt." If the balance was that one-sided, Americans were inclined to feel, then the argument that Japan pursued "one-way" trade policies must have some validity. This presumption made it more difficult for U. S. officials to accommodate Japanese arguments and interests without undermining their credibility at home.

Yet these two circumstances were not so atypical as to make lessons drawn from 1977-80 irrelevant to future U.S.-Japan economic relations. The MTN may be over, but policymakers in both countries will continue to be engaged in multilateral as well as bilateral negotiations, where they must continue to balance domestic political pressures with the needs of U. S.-Japanese relations. The $14 billion Japanese current account surplus is now history, but cyclical fluctuations in world trade balances will surely recur. And the bilateral imbalance in Japan's favor persists and is likely to continue, given the composition of each nation's overall trade. Thus the broad environment for future economic relations seems likely to resemble that of the recent past.

Resolution of future economic conflicts will also be complicated by the inevitable tension between the requirements of U. S.-Japanese relations and other equally legitimate government policy goals. On most 1977-80 trade issues, conflict would have been reduced had the Carter Administration settled for greater trade restrictions at home or less liberalization abroad. Instead, its reluctance to limit steel or auto imports raised the intensity of quota campaigns in the United States, and its pressure to open up Japanese agricultural and telecommunications markets generated controversy across the Pacific. But its broad goal--a relatively open international trading system--served both nations. In years to come as well, each government will recurrently find it necessary to accept some degree of bilateral tension, at least in the short run, in order to hold to a policy objective to which it attaches value.

Thus, lessons drawn from these recent cases can have future relevance. The cases do not, of course, yield precise formulae for effective political management. Issues differ by type, and even within each type. In the future like the past, different substantive problems will engage different groupings of actors within each capital. But barring major institutional changes, these actors will be working within political and governmental systems basically similar to those now in existence.

We therefore present findings and recommendations for the consideration of future officials and policymakers. They are divided into three broad categories--negotiating strategies and channels; perceptions and communications; and national policymaking institutions.

1. Negotiation Strategies and Channels

(a) Pressure Tactics.

One broad theme deserving serious attention is the unique role played in all issues by what Japanese perceive as intense U.S. pressure. On agriculture, NTT, macroeconomic policy, and Iran, the U.S. government employed strong, visible pressure as a catalyst for Japanese policy change. Some Japanese bureaucrats encouraged or welcomed such pressure but many others resented it, and the United States came across as a malign but overpowering force which Japan must accommodate.

In the view from Washington, the high-pressure sequence unfolds roughly as follows. Americans indicate their strong concern about a problem, calling for Japanese policy action but leaving it to Japanese to define the details of that action. Nothing happens--Japanese neither act nor rebut the U.S. case. At the same time, individual bureaucrats suggest to U.S. counterparts that their approach is much too general; that more specific proposals, more forcefully put, are needed to move the Japanese system. The Americans respond with specifics, clearly but diplomatically put, but their demands are leaked, exaggerated, and distorted in the Tokyo press as competitors in the Japanese policy debate seek to turn them to their advantage. Americans may come to see themselves as being used, misrepresented, pawns in a Japanese game they don't understand, their pressure simultaneously encouraged and denounced. But results do follow--Americans see at least some policy gains where they saw none before.

The view from Tokyo is different. Americans are clearly the dominant actors, insisting on defining the issues, talking rather than listening. And in formulating their specific positions, Americans often take cues from the "wrong" Japanese--those on the fringe of Japanese institutions whose role is to communicate with foreigners, or outsiders in a Tokyo policy process seeking to employ U.S. pressure as a way to get in. Americans fail to appreciate the impact of strong U.S. position-taking on a society where the tradition is the opposite--toward deliberate vagueness while consensus is being sought. Thus the same Japanese officials who Americans see as encouraging and using their pressure also resent it--for the jarring style which gives it impact also offends Japanese sensibilities. More generally, Americans come across as either consciously exploiting Japanese vulnerabilities--the need for a conflic free summit conference, for example--or remarkably insensitive to them.

Yet there is broad Japanese recognition that as part of their tradition of adapting to an uncontrollable world, external pressure (*gaiatsu*) plays an important role in bringing--even legitimizing--internal policy change. And in a government characterized by intense competition among closely-knit subgroups, each of which tends to dominate its policy sphere, internal pressure f change is hard to mobilize, whether the goal is Finance Ministry acquiescence in greater government borrowing, or NTT's opening up a system closed not just to foreigners, but to most Japanese firms as well.

But if such strong pressure is often effective, it is also damaging. The image of presumptive American behavior is particularly offensive to Japanese now that the United States is not longer predominant economically, and does not appear to be handling its own economic business very well. Over time, repetition of this high-pressure scenario will reduce America's credibility in the minds of Japanese, with detrimental--perhaps even dangerous--effect on all aspects of U.S.-Japanese relations. And on specific issues, it risks polarizing national positions and amplifying negative images of each country in the minds of citizens in the other. This increases the chances of a truly serious breakdown in relations if political leaders in one country should decide one day to exploit this negative sentiment rather than counter it.

Yet the *gaiatsu* scenario seems to respond to real needs in both countries--it is, after all, played out repeatedly by different officials, on different issues, and usually not by advance design. It is bilateral, two-sided, in its roots. Until the two countries learn to employ other means more effectively to achieve Japanese policy adjustment, they will continue to use this one, whatever dangers it poses. Thus prescription must go beyond deploring this pattern; it must look for alternatives, such as the two governments do employ on many other occasions.

In managing their inevitable economic conflicts, officials in both governments should work very hard to avoid employing (or seeming to employ) intense, highly visible U.S. pressure as the catalyst for Japanese policy change.

For Japanese, the need is to *respond earlier*, to "softer" signals (as did the steel industry in 1977), and to *find alternative sources of support for internal policy change*. For instance, necessary economic changes (such as liberalization of import quotas) should be argued *on their own merits*, and supported by interest groups with stakes in an open international economy. For Americans, the need is not to abandon efforts to influence the Japanese government, but to *resist invitations to escalate*, to be firm and persistent about *U.S.* aims without presuming to dominate *Japanese* behavior, to *look for issue-specific sources of leverage* insofar as possible *rather than linking economic issues in a broad package which appears as a frontal challenge to Japan as a society*. At times, as on steel, a unilateral U.S. solution may be feasible, adopted with consultation and Japanese cooperation in its execution.

(b) *Intrusion in "Domestic" Issues*.

U.S. pressure was particularly resented by Japanese when perceived as an intrusion in issues normally considered "domestic." In 1977-78, as we noted, U.S. officials "negotiated" with Japanese on such issues as the JFY 1978 growth target, the ratio of Japanese government borrowing to total expenditure, and additional steps to stimulate domestic demand. This approach achieved some concrete results. But it generated a severe backlash--many Japanese were resentful of such American presumption, especially in a period when the U.S. seemed to be mismanaging its own economy. And *it created the false impression*, among attentive Americans, *that the Japanese government could fine-tune its aggregate economic performance* and should be held accountable for doing so.

One problem was that Americans increasingly lacked credibility on economic policy, as U.S. inflation rose and the dollar's value plummeted. More important is the fact that the Japanese people have grown fiercely proud of their rise to top-level economic status. Thus they increasingly resent foreign actions--however well-motivated--which seem to imply that Japan remains a protege requiring tutelage, or a weak nation which must submit. Americans should find this easy to understand, for they react strongly to hints of foreign intervention in their domestic policymaking. When, for example, the Japanese government suggested during the textile wrangle of 1969-71 that the U.S. Tariff Commission investigate whether imports had injured the American textile industry, U.S. officials were livid. They felt such a suggestion was totally inappropriate for a foreign government to make. (The Textile Wrangle: 161)

To sum up, American officials need to beware of intruding too deeply in Japanese economic decisionmaking, particularly on issues normally considered "domestic." And Japanese should be careful about inviting such intrusion.

When the two countries do negotiate on broad economic policies, they should seek both the fact and the appearance of reciprocity. In this respect, the language of the Carter-Ohira communique of May 1979 was preferable to that in the Strauss-Ushiba Joint Statement of January 1978.

(c) Scapegoating.

In the steel and auto issues, as earlier noted, pressure was exerted indirectly through the Japanese reading of American public statement. This sometimes made the interests involved more responsive to U.S. concerns. But it also generated resentment and a sense of being beset and victimized, by Americans who lack understanding of Japan's real situation. Tokyo was in turn upset by what were perceived as one-sided and oversimplified presentations of the reality. Indeed, the U.S. steel industry aggressively promoted the view that an "unfair Japan" was a prime source of its economic problems, even though it was Europe that was most obviously "dumping" steel on U.S. markets; other American manufacturers have made similar charges, especially in consumer electronics.

On agriculture, United States officials focused criticism on the "closed nature" of the Japanese markets while often failing to take note of the fact that Japan was the world's single largest customer for American agricultural products, with imports over four billion dollars, or the fact that the United States itself restricted beef and citrus imports. Such scapegoating is amplified by Japanese media, while simultaneously distracting Americans from the domestic roots of trade problems, including diminished industrial competitiveness.

In Japan, bureaucrats sometimes use the United States as a scapegoating, as when some used American pressure in the fall of 1977 as an excuse for economic and trade policy changes they favored on other grounds. And because of the attention gap, perceived American actions have far more impact in Tokyo than perceptions of Japanese policy have in Washington. But in both capitals, scapegoating nourished negative images which poison the well of future relations. Thus, *Americans and Japanese must beware employing the other country as a "scapegoat," despite short-run political gains in so doing*.

(d) *Lack of Specificity*.

In both the agriculture and NTT cases, the United States began by asking for full liberalization--elimination of quotas and internationalization of all telecommunication procurement. But even though initial talks indicated that this was impractical, STR Robert Strauss was slow to specify what concrete steps the U.S. most wanted and what it would settle for. One reason was domestic politics--he did not want to appear to be choosing between Florida and California orange growers, for example, and when a particular U.S. position in fact leaked in the summer of 1978, it angered producers in *both* states. Nonetheless, this reluctance made it hard for Japanese political leaders and senior officials to begin their lengthy consensus-building process, particularly when Americans kept repeating the very threatening "liberalization" goal. Similarly, the lack of clear U.S. signals made it harder for MITI to press Japanese automobiles for import restraints in 1980. Hence, *when seeking trade concessions, it is important to be as specific as possible, as early as possible, about the actions sought from the other government*.

(e) Summit Linkage.

The NTT issue came to be linked with the Carter-Ohira summit, and Japanese saw the U.S. as seeking to force concessions by threatening to make the Prime Minister's U.S. visit a failure. In fact this was not the overall U.S. strategy, though some officials did apparently entertain this idea. In any event, such linkage was misguided, for the U.S. was as likely to back down as Japan--as indeed the U.S. did, settling for a procedural compromise. Moreover, the summit offered little leverage on the politics of the NTT "family"; it was not likely to make Hitachi, NEC, Fujitsu, or Oki Electric any more receptive to modifying their close and profitable NTT relationships.

Summit conferences can, of course, sometimes facilitate important breakthroughs on issues where the groundwork has been prepared at the working level. Prime Minister Eisaku Sato's talks with President Lyndon B. Johnson in 1967 and with President Richard Nixon in 1969 played this role on Okinawa reversion. But on the textile issue--where the groundwork had not been laid--Sato's summit discussions with Nixon in 1969 and 1970 proved disastrous. (Managing An Alliance: 154-57.)

In short, a summit meeting cannot force settlement of a difficult bilateral problem unless a basis for substantive agreement has been prepared in advance. Otherwise, linking an issue to a summit may only exacerbate controversy without achieving resolution.

(f) Trips by Hardliners.

In the course of the agriculture issue many Japanese farm representatives and agricultural politicians visited the United States. As a result, some of them considerably softened their position against import expansion and acquiesced in the compromise between the two governments, though their repetition of the same arguments had often exasperated the American officials they encountered. Similarly, some American visitors to Japan in 1977 apparently became less outspoken about "dumping" after seeing modern Japanese steel plants. It is sometimes useful, therefore, to send domestic "hawks" to the other country on factfinding missions, for their exposure to direct pressure from the other side (or to actual industry operations on the other side) often helps soften their stand.

(g) Consultations among Experts.

The macroeconomic policy dialogue of 1977-79 was damaged by the low credibility of Japanese government current account projections--they had grossly underestimated the surpluses of 1977 and 1978, and Americans feared a repeat in 1979. But the dispatch of a special team of U.S. economic forecasters to Tokyo in January 1979 led to their concluding that the official Japanese current account forecast for FY 1979 was a reasonable one. When they returned home, they were successful in persuading their superiors. The mission's success was due, in larger part, to two factors: it addressed a problem of major current concern to those shaping U.S. policy toward Japan; the team's expertise was directly relevant to the problem.

Thus, when the two governments seem to be operating on divergent assumptions about economic facts and trends, serious analytic dialogue between their senior exports can prove highly useful.

2. Perceptions and Communications

(a) Obsolete Attitudes.

Some Japanese still cannot overcome the amae mentality imprinted by the postwar dependent relationship with the United States, which leads them to unrealistic expectations of U.S. policy. To the extent that they are aware of difficulties facing the United States they tend to be unusually impatient with them. Some Americans, on the other hand, still seem to hold the image of the United States as the senior partner of that dependent relationship, thus expecting the Japanese to accede to American requests at all times and at any cost. But economic and political trends have long since rendered the postwar "father-son" relationship obsolete. The reality is that both governments must deal with increasingly assertive domestic interests, at the very time when there is a greater need to coordinate their economic policies internationally. This means that policymakers in both countries need to pay greater attention to the domestic political matrix of the other side as well as their own in working out a bilateral issue settlement. Indeed, a key to effective management of bilateral issues is reciprocal political sensitivity.

Unfortunately, current trends seem to be in the opposite direction. As an astute American economic journalist has noted, "Economic pressures and rising chauvinism in each country have created an increasingly intolerable political climate toward the other." (Samuelson: 1070). This problem was present in all five cases of this study--but particularly in NTT, autos, and macroeconomic policy. In agriculture, as we noted, political leaders in both countries did prove effective in demonstrating reciprocal political sensitivity, despite difficult domestic pressures.

(b) "Japan, Inc."

MITI is not nearly as all-powerful as U.S. officials often believe, and U.S. officials tend to exaggerate the harmony of Japan's government-business relationships. In fact, MITI's leverage over Japanese firms has decreased since the early postwar period, and government-business consensus seems to have weakened on policy issues. MITI worked hard to persuade Toyota and Nissan to build plants in the United States, but with limited success. Only the threat of substantial U.S. trade restrictions seems to have made Nissan and Toyota move, finally, in this direction. The Japanese government has even had difficulty in persuading a semi-government organization like NTT.

In summary, despite the still prevalent image of "Japan, Inc." in the United States, the Japanese government appears to have decreasing leverage over Japanese business firms. Thus, it is necessary for the United States to scale down expectations that it can easily induce such firms to respond to U.S. interests.

(c) Japanese Reticence.

The problem of misperception between the United States and Japan is usually exacerbated by the fact that while Americans often employ an adversary style of bargaining, emphasizing the negative aspects of the other side (as lawyers do in court), Japanese tend to remain reticent. This can lead Americans to conclude that Japanese are acknowledging guilt. American actions based on that assumption in turn breed further Japanese resentment.

At the IMF meeting in the fall of 1977 Japan's macroeconomic policy was severely criticized. But the Minister of Finance returned to Japan without even attempting a rebuttal, and later attempts by Finance Ministry bureaucrats to do so were too late. It was only much later that Japan began to criticize the U.S. inflation, oil imports and "benign neglect" of the dollar.

In the future, Japanese negotiators should speak up more, countering American criticism as squarely as possible, to minimize misunderstandings and misperceptions. When the U.S. government criticizes Japanese policy and/or makes a specific demand, the Japanese government should respond with rational explanations of its position and counter-arguments--instead of saying nothing, appearing to acquiesce, or simply saying "no."

(d) Japan's Hyper-Sensitivity.

American politics is vocal and decentralized, generating an enormous volume of words and actions, most without enduring impact, Tokyo media naturally select and amplify those that refer to Japan. For example, in criticizing increasing Japanese auto imports, U.S. Steel Chairman David Roderick (successor to Edgar Speer) charged that the Japanese were "dumping." This comment got widespread press attention in Japan, even though Roderick was not directly involved in the auto issue and charges of Japanese "unfairness" have not been an important theme of American auto quota advocates. Similar statements by U.S. Congressional or academic critics also tend to get wide publicity in Tokyo. This reflects the broader attention gap--a statement about the United States by a Japanese industry leader or Diet member would not normally find its way into the U.S. media at all!! Very often even the Japanese Foreign Minister's visits to Washington fail to be noted in the American press.

Thus, Japanese government, media, and other leaders should help their countrymen put specific U.S. events in broader perspective. Not every Congressional speech matters; not every criticism of Japan reflects a broadly-held view.

3. National Policymaking Institutions

(a) Political Leadership.

The power of special economic interests seems to be increasing in both Japan and the United States. Nor, with the partial exception of automobiles (and, for a time, steel), have consumer interests emerged as an effective counterforce. In the United States Congress, members complain of growing pressure from narrow interests and "single-issue" lobbies. And within government, numerous agencies are involved in international economic issues. In Japan, sectionalism in the bureaucracy produces alignments with special interests that Ministers have difficulty resisting. Thus there is a particular need in both countries for adroit political leaders.

In the United States, Robert Strauss combined inborn political talent with ties to the President, Congress, and American domestic politics, and was able to keep the domestic initiative on trade issues. This meant he could, usually, control the U.S. side of bilateral negotiations and prevent the proliferation of channels. His successor has found it hard to establish comparable political dominance, as U.S. auto policy demonstrates.

On the Japanese side, the government would not have been able to win acceptance of the agriculture agreement had it not been for the effective leadership exercised by Nakagawa and Ushiba.

In any case, it is worth stressing that both countries need strong political leaders to take charge of major trade negotiations and facilitate effective political management both at home and abroad. This need is particularly acute in the United States, given its greater dispersion of power over international economic policy.

(b) Country Experts.

A common Japanese complaint is the limited number of "Japan experts" in Washington. Reciprocally, American officials remark on the rareness of those Japanese bureaucrats with whom they can communicate effectively, and the enormously useful intermediary role played by those who do. Both governments need to encourage development of more such people, place them in positions important to U.S.-Japanese relations, yet guard against them becoming "labeled" in their own government as "advocates for the Japanese," or the Americans, and thus discounted. In other words, both governments need to expand the number of career officials who are knowledgeable about the other country and skilled in communicating with its officials.

(c) Watchdogs on Bilateral Economic Relations.

In assisting political leaders and career officials who manage bilateral economic relations, a useful role can be played by small groups of consequential figures (based on either country or both) that combine detachment from current executive responsibilities with serious attention to bilateral economic issues.

The Task Force on United States-Japan Trade of the House Ways and Means Committee has evolved into one such group. Its second comprehensive report, published in September 1980, is an unusually balanced and informative discussion of the overall relationship and particular issues within it. It can prove helpful in balancing the considerable flow of information from special-interest sources, and in providing continuous, constructive influence on both governments.

The "Trade Study Group" (a private voluntary group of American and Japanese businessmen) has also been playing a useful role by conducting a broad study of nontariff barriers and making recommendations to Japanese government bodies.

Last but not least, the Japan-United States Economic Relations Group ("Wisemen's Group") can also play an important advisory role. The particular value of the Group lies in the completely binational nature of the membership and the staff work.

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Key Economic Statistics in the U.S.-Japan Relationship

Collected and assembled by
Scott Davidson
Staff
Japan-United States Economic
Relations Group

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Domestic Economic Performance
United States

	1970	1971	1972	1973	1974	1975
GNP at current prices Billion $	982.4	1,063.4	1,171.1	1,306.6	1,412.9	1,528.8
GNP Growth Rates at 1972 prices	-0.3	3.0	5.7	5.5	-1.4	-1.3
Ratio of Exports to GNP f.a.s.	4.3	4.1	4.2	5.4	6.9	7.0
Ratio of Imports to GNP c.i.f.	4.3	4.6	5.1	5.6	7.6	6.8
Ratio of Gross Fixed Cap. Form to GNP	17.3	17.7	18.3	18.4	17.8	16.3
Savings as % of disposable personal income	7.4	7.7	6.2	7.8	7.3	7.7
Capacity Util (%)	83.9	82.5	87.8	93.0	90.5	80.0
Unemployment (%)	4.9	5.9	4.9	5.6	8.5	7.7
Consumer Prices % change over previous year	5.9	4.3	3.3	6.3	10.9	9.2
Wholesale Prices % change over previous year	3.6	3.3	4.4	13.1	18.8	9.3
Hourly Comp 1967 =100	121.8	129.5	136.6	146.4	161.1	180.2
Productivity in Manufacturing 1967=100	105.0	110.1	115.7	118.8	112.6	118.8

	1976	1977	1978	1979	1980		
					I	II	IIIp
GNP at current prices Billion $	1,702.2	1,899.5	2,127.6	2,369	2,521.0	2,521	2,583
GNP Growth Rates at 1972 prices	5.9	5.3	4.4	2.3	1.2	-9.6	1.0
Ratio of Exports to GNP f.a.s.	6.7	6.3	6.6	7.5	8.3	8.5	8.5
Ratio of Imports to GNP c.i.f.	7.6	8.3	8.6	9.2	NA	NA	NA
Ratio of Gross Fixed Cap. Form to GNP	16.4	17.2	18.0	17.9	17.7	16.1	16.4
Savings as % of disposable personal income	5.8	5.0	4.9	4.5	NA	NA	NA
Capacity Util.(%)	86.0	88.5	91.8	92.7	91.4	NA	NA
Unemployment (%)	7.7	7.0	6.0	5.8	6.1	NA	7.5
Consumer Prices % change over previous year	5.8	6.5	7.7	11.3	3.9	3.6	1.9
Wholesale Prices % change over previous year	4.6	6.1	7.8	12.6	4.6	2.0	3.1
Hourly Compensation 1967=100	195.1	212.0	229.5	250.8	NA	NA	NA
Productivity in Manufacturing 1967=100	124.0	127.7	128.2	129.2	NA	NA	NA

Source: International Economic Indicators

Domestic Economic Performance
Japan

	1970	1971	1972	1973	1974	1975
GNP at current prices Billion Y	73,503	80,915	92,754	113,090	135,065	148,79
GNP Growth Rates at 1972 prices	11.7	5.3	9.5	10.0	-0.5	1.4
Ratio of Exports to GNP f.o.b.	9.5	10.4	9.5	8.9	12.0	11 1
Ratio of Imports to GNP c.i.f.	9.2	8.5	7.8	9.2	13.4	11.5
Ratio of Gross Fixed Cap. Form to GNP	35.4	34.2	34.0	36.6	34.8	32.2
Savings as % of disposable personal income	18.1	17.5	18.0	20.5	23.7	22.5
Capacity Util (%)	98.1	92.4	91.3	98.0	89.1	74.9
Unemployment (%)	1.2	1.3	1.4	1.3	1.4	1.9
Consumer Prices % change over previous year	7.6	6.0	4.6	11.8	24.3	11.9
Wholesale Prices % change over previous year	3.7	-0.8	0.8	15.8	31.4	3.0
Hourly Comp. 1967=100	165.9	197.3	259.2	353.7	431.2	497.2
Productivity in Manufacturing 1967=100	146.5	151.0	162.3	181.2	181.7	174.6

	1976	1977	1978	1979	1980 I	 II
GNP at current prices Billion Y	167,295	186,209	205,046	221,583	228,506	234,420
GNP Growth Rates at 1972 prices	6.5	5.4	6.0	5.9	7.6	2.5
Ratio of Exports to GNP f.o.b.	11.9	11.6	10.0	10.2	10.5	12.3
Ratio of Imports to GNP c.i.f.	11.5	10.3	8.2	10.9	11.9	15.0
Ratio of Gross Fixed Cap Form to GNP	31.0	30.1	30.2	31.6	31.5	31.8
Savings as % of disposable personal income	22.4	21.1	20.1	NA	NA	NA
Capacity Util (%)	77.9	77.5	77.9	80.2	NA	NA
Unemployment (%)	2.0	2.0	2.2	2.1	1.9	2.0
Consumer Prices % change over previous year	9.3	8.1	3.8	3.6	2.1	3.3
Wholesale Prices % change over previous year	5.0	1.9	-2.5	7.3	6.5	4.8
Hourly Comp. 1967=100	538.3	644.5	870.2	885.5	NA	NA
Productivity in Manufacturing 1967=100	188.7	197.3	212.9	230.5	NA	NA

US Japan Trade Summary
United States Data
$ Million

	1970	1971	1972	1973	1974	1975
Imports from Japan	5,894	7,278	9,076	9,665	12,414	11,257
Exports to Japan	4,650	4,053	4,963	8,356	10,724	9,567
erch.Trade Bal.	-1,244	-3,225	-4,113	-1,309	-1,690	-1,690
Service exports to Jpn.	1,178	1,500	1,700	2,588	3,552	2,647
Service Imports from Jpn.	1,524	1,702	2,351	2,702	2,760	2,824
ervice Balance	-346	-202	-651	-114	792	-177
US assets in Jpn.	636	920	247	2,099	6,314	-1,552
Jpn. assets in US	1,101	10,004	5,087	-6,882	2,744	-574
apital Balance	465	9,084	4,840	8,981	-3,570	-2,126
urrent Account	-1,541	-3,475	-4,806	-1,463	-944	-1,410

ource: Survey of Current Business

Japan US Trade Summary
Japanese Data
$ Million

	1970	1971	1972	1973	1974	1975
Exports to the US	6,000	7,547	8,903	9,432	12,688	10,935
Imports from the US	4,535	4,173	4,953	8,120	10,795	9,885
erch.Trade Bal	.1,465	3,374	3,950	1,312	1,893	1,045
Service Export to US	2,015	2,398	3,116	3,929	5,374	5,646
Service Import from US	2,654	3,072	3,649	5,038	7,882	7,553
Service Balance	-644	-674	-533	-1,109	-2,508	-1,907
Jpn. Invest in US	300	356	2,113	1,938	493	524
US Invest in Jpn.	82	589	384	-424	-425	487
Long Term Cap. Bal	-218	233	-1,729	-2,362	-918	-37
Current Account	857	2,756	3,351	104	-693	-935

Source: Bank of Japan, Balance of Payments Monthly

US Japan Trade Summary
United States Data
$ Million

	1976	1977	1978	1979	1980 (Jan-Oct)1	
Imports from Japan	15,531	18,565	24,541	26,255	25,395.8	
Exports to Japan	10,196	10,566	12,960	17,627	17,085.9	
Merch. Trade Bal.	-5,335	- 7,999	-11,581	-8,628	-8,309.9	
Service Exports to Jpn.	3,376	3,790	5,243	6,392	NA	NA
Service Imports from Jpn.	3,404	3,873	5,369	5,867	NA	NA
Service Balance	-28	-83	-126	525	NA	NA
US Assets in Jpn	605	-541	5,957	5,500	NA	NA
Jpn Assets in US	3,791	6,329	13,749	-12,074	NA	NA
Capital Balance	3,186	6,870	7,792	-17,574	NA	NA
					I	II
Current Account	-5,405	- 8,126	-11,782	-8,667	-1,907	-2,488

Source: Survey of Current Business
1 Bureau of the Census, FT 990

Japan US Trade Summary
Japanese Data
$ Million

	1976	1977	1978	1979	1980
Exports to the US	15,635	19,388	24,652	26,004	NA
Imports from the U.S.	10,104	10,727	14,041	18,367	NA
Merch. Trade Bal.	5,531	8,661	10,661	7,637	NA
Service Export to US	5,747	6,377	7,413	9,878	NA
Service Import from U.S.	7,746	8,225	9,216	12,473	NA
Service Balance	-1,999	-1,848	-1,803	-2,595	NA
Jpn. Invest.. in U.S.	-374	-346	-2,634	-2,153	NA
U.S. Invest. in Jpn.	598	361	-699	673	NA
Long Term Cap. Bal	224	15	-3,333	-1,480	NA
Current Account	3,437	6,770	8,668	4,861	NA

Source: Bank of Japan, Balance of Payments Monthly

United States Imports from Japan

$ Million (f.a.s)

	1970	1971	1972	1973	1974	1975
Imports Total	5,875.5	7,260.9	9,064.3	9,644.8	12,337.6	11,268.0
Agricultural	37.1	46.7	53.4	57.2	69.9	63.9
% of total	(0.63%)	(0.69%)	(0.58%)	(0.59%)	(0.56%)	(0.57%)
Non Agricultural	5,838.2	7,214.2	9,010.9	9,587.7	12,267.7	11,204.1
% of total	(99.0%)	(99.0%)	(99.0%)	(99.0%)	(99.0%)	(99.0%)
Food & Live An.	163.0	166.7	245.2	273.6	311.1	172.1
% of total	(2.7%)	(2.2%)	(2.7%)	(2.8%)	(2.5%)	(1.5%)
Beverages & Tobacco	2.2	2.8	3.8	5.0	6.4	5.0
% of total	(0.04%)	(0.04%)	(0.05%)	(0.05%)	(0.05%)	(0.04%)
Crude Materials Except Fuels	34.3	43.2	47.6	60.4	86.3	54.3
% of total	(0.58%)	(0.59%)	(0.53%)	(0.63%)	(0.7%)	(0.48%)
Mineral Fuels, Lubricants & Related	2.0	3.6	10.9	21.6	12.5	4.2
% of total	(0.03%)	(0.05%)	(0.1%)	(0.2%)	(0.1%)	(0.04%)
Oils & Fats-Animal and Vegetable	4.2	7.1	3.0	2.3	4.5	8.0
% of total	(0.02%)	(0.1%)	(0.03%)	(0.02%)	(0.04%)	(0.07%)
Chemicals and Related Products	176.1	196.2	250.3	238.7	486.4	387.4
% of total	(2.9%)	(2.7%)	(2.7%)	(2.5%)	(3.9%)	(3.4%)
Manufactured Goods	1,894.6	2,157.8	2,394.1	2,441.3	3,573.7	3,484.7
% of total	(32.0%)	(29.7%)	(26.0%)	(25.0%)	(28.9%)	(30.9%)
Machinery and trans.equip.	2,243.0	3,214.1	4,292.6	4,745.6	6,098.6	5,596.2
% of total	(38.0%)	(44.0%)	(47.0)	(49.0%)	(49.0%)	(49.6%)
Misc. manufactured goods	1,277.8	1,377.1	1,721.9	1,756.4	1,621.3	1,400.4
% of total	(21.7%)	(18.9%)	(18.9%)	(18.0%)	(13.0%)	(12.0%)
Commodites and Transactions NEC	78.1	92.4	94.9	99.8	136.6	155.7
% of total	(1.0%)	(1.0%)	(1.0%)	(1.0%)	(1.0%)	(1.0%)

Source U.S.Department of Commerce, Bureau of the Census, FT 990

United States Imports from Japan
$ Million (f.a.s.)

	1976	1977	1978	1979	1980. (Jan-Oct)
Imports Total	15,504.2	18,622.7	24,457.8	26,242.9	25,395.8
Agricultural	76.3	79.2	101.7	89.0	79.9
% of total	(0.49%)	(0.4%)	(0.4%)	(0.3%)	(0.3%)
Non Agricultural	15,427.9	18,543.5	24,356.1	26,153.8	25,315.8
% of total	(99.5%)	(99.5%)	(99.6%)	(99.6%)	(99.7%)
Food & Live An.	257.7	243.0	266.7	220.5	220.1
% of total	(1.6%)	(1.0%)	(1.0%)	(0.8%)	(0.87%)
Beverages & Tobacco	5.7	5.2	7.1	7.6	7.8
% of total	(0.04%)	(0.02%)	(0.03%)	(0.03%)	(0.03%)
Crude Materials Except Fuels	51.7	63.4	60.3	63.9	46.8
% of total	(0.3%)	(0.3%)	(0.2%)	(0.2%)	(0.2%)
Mineral Fuels, Lubricants & Related	.8	6.2	25.3	88.9	44.9
% of total	(0.005%)	(0.03%)	(0.1%)	(0.3%)	(0.2%)
Oils & Fats-Animal and Vegetable	3.5	4.7	4.9	5.2	4.7
% of total	(0.02%)	(0.03%)	(0.02%)	(0.02%)	(0.02%)
Chemicals and Related Products	398.2	465.0	563.0	616.1	576.2
% of total	(2.5%)	(2.5%)	(2.0%)	(2.3%)	(2.3%)
Manufactured Goods	3,827.2	4,305.2	4,792.7	5,101.8	4,673.5
% of total	(24.7%)	(23.0%)	(19.5%)	(19.0%)	(18.4%)
Machinery and trans.equip.	8,726.8	10,670,1	16,038.6	17,497.5	17,238.4
% of total	(56.0%)	(57.0%)	(65.5%)	(66.0%)	(67.9%)
Misc. manufactured, goods	2,089.9	2,700.5	2,533.2	2,440.9	2,241.6
% of total	(13.0%)	(14.5%)	(10.0%)	(9.0%)	(8.8%)
Commodites and Transactions NEC	142.7	159.5	166.1	200.5	341.8
% of total	(0.9%)	(0.9%)	(0.68%)	(0.76%)	(1.3%)

Source: U.S. Department of Commerce, Bureau of the Census, FT990

United States Exports to Japan

$ Million (f.a.s.)

	1970	1971	1972	1973	1974	1975
xports Total	4,609.7	4,012.4	4,888.8	8,176.1	10,563.8	9,421.0
gricultural	1,214.1	1,073.0	1,429.4	2,997.1	3,478.9	3,081.9
of total	(26.0%)	(26.7%)	(29.0%)	(37.0%)	(33.0%)	(33.0%)
on Agricultural	3,395.6	2,939.4	3,459.4	5,179.0	7,084.9	6,339.1
of total	(73.6%)	(73.0%)	(71.0%)	(63.0%)	(67.0%)	(67.0%)
ood & Live An.	663.7	531.5	686.3	1,817.4	2,071.4	1,981.9
of total	(14.0%)	(13.0%)	(14.0%)	(22.0%)	(19.6%)	(21.0%)
everages & Tobacco	65.7	26.7	112.8	116.2	189.1	162.2
of total	(1.0%)	(0.6%)	(2.0%)	(1.0%)	(1.8%)	(1.7%)
rude Materials xcept Fuels	1,305.5	1,027.8	1,368.6	2,473.6	2,669.7	2,321.7
of total	(28.0%)	(25.6%)	(28.0%)	(30.0%)	(25.0%)	(24.6%)
ineral Fuels, Lubri ants & Related	524.0	447.4	443.1	499.1	1,446.9	1,572.9
of total	(11.0%)	(11.0%)	(9.0%)	(6.0%)	(13.7%)	(16.7%)
ils & Fats-Animal nd Vegetable	39.3	34.4	33.1	74.8	102.0	39.7
of total	(0.85%)	(0.85%)	(0.67%)	(0.9%)	(0.97%)	(0.4%)
hemicals and elated Products	322.0	323.9	312.5	629.4	765.9	589.0
of total	(6.9%)	(8.0%)	(6.0%)	(7.7%)	(7.0%)	(6.0%)
anufactured Goods	243.4	190.6	305.9	597.7	626.4	486.2
of total	(5.0%)	(4.8%)	(6.0%)	(7.0%)	(5.9%)	(5.0%)
achinery and rans.equip.	1,146.0	1,129.9	1,223.2	1,494.8	2,117.4	1,698.3
of total	(25.0%)	(28.0%)	(25.0%)	(18.0%)	(20.0%)	(18.0%)
isc. manufactured oods	240.1	259.8	347.2	408.1	470.2	435.6
of total	(5.0%)	(6.0%)	(7.0%)	(4.9%)	(4.5%)	(4.6%)
ommodites and ransactions NEC	19.8	18.2	22.1	35.5	45.4	39.7
of total	(0.4%)	(0.45%)	(0.45%)	(0.4%)	(0.4%)	(0.4%)

ource: U.S.Department of Commerce, Bureau of the Census, FT 990

United States Exports to Japan
$ Million (f.a.s)

	1976	1977	1978	1979	1980. (Jan-Oct)
Exports Total	10,027.5	10,414.3	12,689.3	17,386.2	17,085.9
Agricultural	3,563.1	3,856.8	4,435.3	5,255.3	4,821.3
% of total	(36.0%)	(37.0%)	(35.0%)	(30.0%)	(28.2%)
Non Agricultural	6,464.4	6,557.5	8,254.0	12,112.9	12,170.9
% of total	(64.0%)	(63.0%).	(65.0%)	(69.7%)	(71.2%)
Food & Live An.	2,194.5	2,235.6	2,996.4	3,611.9	3,394.2
% of total	(21.9%)	(21.0%)	(24.0%)	(21.0%)	(19.9%)
Beverages & Tobacco	65.7	26.7	112.8	116.2	109.4
% of total	(0.65%)	(0.3%)	(0.88%)	(0.66%)	(0.6%)
Crude Materials Except Fuels	2,588.4	2,930.9	3,664.8	4,994.9	4,699.1
% of total	(26.0%)	(28.0%)	(29.0%)	(29.0%)	(27.5%)
Mineral Fuels, Lubricants & Related	234.4	1,109.8	817.9	1,209.4	1,379.0
% of total	(2.0%)	(11.0%)	(6.0%)	(6.9%)	(8.1%)
Oils & Fats-Animal and Vegetable	55.8	59.6	59.8	80.2	67.8
% of total	(0.55%)	(0.6%)	(0.5%)	(0.46%)	(0.4%)
Chemicals and Related Products	851.8	976.9	1,104.1	1,651.6	1,665.7
% of total	(8.0%)	(9.0%)	(8.7%)	(9.5%)	(9.7%)
Manufactured Goods	581.2	548.8	605.8	935.4	1,328.4
% of total	(5.8%)	(5.0%)	(4.7%)	(5.4%)	(7.8%)
Machinery and trans.equip.	1,727.3	1,672.4	2,226.9	3,218.1	3,156.8
% of total	(17.0%)	(16.0%)	(17.5%)	(19.0%)	(18.5%)
Misc. manufactured, goods	492.1	525.6	834.3	1,196.8	1,044.8
% of total	(4.9%)	(5.0%)	(6.6%)	(6.9%)	(6.1%)
Commodites and Transactions NEC	22.5	23.3	73.9	103.6	74.2
% of total	(0.2%)	(0.2%)	(0.58%)	(0.59%)	(0.4%)

Source U.S.Department of Commerce, Bureau of the Census, FT 990

Japan's Imports from the US

$ Million (c.i.f.)

	1970	1971	1972	1973	1974	1975
tal Imports om US	5,559.6	4,977.9	5,851.6	9,269.6	12,682.2	11,608.1
od	812.2	735.7	868.1	1,978.9	2,605.5	2,488.9
of Total	(15.0%)	(12.0%)	(15.0%)	(21.0%)	(21.0%)	(21.0%)
xtile Materials	83.2	126.5	123.5	216.8	329.9	281.5
of Total	(1.5%)	(2.0%)	(2.0%)	(2.0%)	(3.0%)	(2.0%)
tal ores & rap	430.9	171.9	164.1	435.1	476.1	367.4
of total	(7.8%)	(3.0%)	(3.0%)	(5.0%)	(4.0%)	(3.0%)
w Materials	1,135.1	1,041.4	1,424.4	2,235.1	2,586.1	2,495.3
of Total	(20.0%)	(18.0%)	(24.0%)	(24.0%)	(20.0%)	(21.5%)
neral Fuels	760.8	618.8	570.5	64.3	1,815.4	1,908.6
of Total	(14.0%)	(10.0%)	(9.7%)	(0.7%)	(14.0%)	(16.0%)
emicals	400.9	378.6	411.1	715.6	1,017.3	775.2
of Total	(7.2%)	(6.4%)	(7.0%)	(8.0%)	(8.0%)	(7.0%)
chinery & Equip.	1,411.6	1,417.0	1,498.6	1,866.4	2,550.2	2,195.0
of Total	(25.0%)	(24.0%)	(26.0%)	(20.0%)	(20.0%)	(19.0%)
ners	524.9	488.1	791.3	1,110.4	1,301.8	1,096.1
of Total	(9.4%)	(8.2%)	(13.0%)	(12.0%)	(10.0%)	(9.0%)

urce: Summary Report Trade of Japan
Japan Tariff Association

Japan's Exports to the US

$ Million (f.o.b.)

	1970	1971	1972	1973	1974	1975
tal Exports US	5,939.8	7,495.3	8,847.7	9,448.7	12,799.4	11,148.6
od Stuffs	135.4	138.4	222.1	254.1	242.4	164.7
of Total	(2.0%)	(1.8%)	(2.5%)	(2.7%)	(2.0%)	(1.0%)
xtiles	596.6	696.9	618.3	522.9	489.0	432.2
of Total	(10.0%)	(9.3%)	(6.9%)	(6.0%)	(4.0%)	(4.0%)
emicals	160.3	191.1	246.2	238.8	574.0	345.5
of Total	(2.7%)	(2.5%)	(2.7%)	(3.0%)	(4.0%)	(3.0%)
nmetallic Mineral nufactured	147.8	146.2	186.3	205.9	202.4	180.2
of Total	(2.5%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)	(2.0%)
tal Products	1,296.3	1,397.6	1,567.9	1,572.0	3,240.0	2,498.5
of Total	(22.0%)	(19.0%)	(18.0%)	(17.0%)	(25.0%)	(22.0%)
chinery and Equip	2,841.5	4,067.4	5,094.9	5,773.8	7,083.6	6,664.0
of Total	(48.0%)	(54.0%)	(58.0%)	(61.0%)	(55.0%)	(60.0%)
hers	761.9	857.5	912.0	881.2	968.0	863.4
of Total	(13.0%)	(11.0%)	(10.0%)	(9.0%)	(8.0%)	(8.0%)

ource: Summary Report Trade of Japan
Japan Tariff Association

Japan's Imports from the US

$ Million (c.i.f.)

	1976	1977	1978	1979	1980 (Jan-Aug)
Total Imports from US	11,809.3	12,396.1	14,790.4	20,430.4	16,212.1
Food	2,684.2	2,734.2	3,564.4	4,422.9	3,202.9
% of Total	(23.0%)	(22.0 %)	(24.0%)	(21.6%)	(20.0%)
Textile Materials	268.1	357.1	382.4	539.6	471.4
% of Total	(2.0%)	(3.0%)	(2.5%)	(2.6%)	(2.9%)
Metal ores & Scrap	240.2	224.8	506.9	863.9	839.8
% of Total	(2.0%)	(1.8%)	(3.0%)	(4.0%)	(5.2%)
Raw Materials	2,642.1	3,017.7	3,295.4	4,608.2	3,258.3
% of Total	(22.0%)	(24.0%)	(22.0%)	(23.0%)	(20.1%)
Mineral Fuels	1,447.3	1,350.2	915.6	1,357.3	1,295.2
% of Total	(12.0%)	(11.0%)	(6.0%)	(7.0%)	(8.0%)
Chemicals	1,083.9	1,152.6	1,408.3	2,053.3	1,692.5
% of Total	(9.0%)	(9.0%)	(9.5%)	(10.0%)	(10.4%)
Machinery & Equip.	2,251.7	2,368.8	3,057.8	4,310.2	3,391.1
% of Total	(19.0%)	(19.0%)	(20.6%)	(2.0%)	(20.9%)
Others	1,191.7	1,190.7	1,657.6	2,275.3	2,060.9
% of Total	(10.0%)	(9.6%)	(11.0%)	(11.0%)	(12.7%)

Source: Summary Report Trade of Japan
Japan Tariff Association

Japan's Exports to the US

$ Million (f.o.b.)

	1976	1977	1978	1979	1980 (Jan-Aug)
Total Exports to U.S.	15,689.6	19,716.9	24,914.7	26,402.5	20,098.1
Food Stuffs	236.0	199.6	217.8	189.0	154.6
% of Total	(1.5%)	(1.0%)	(0.9%)	(0.7%)	(0.8%)
Textiles	575.8	669.2	709.6	522.4	369.1
% of Total	(3.7%)	(3.0%)	(3.0%)	(1.9%)	(1.8%)
Chemicals	413.1	487.9	592.1	653.1	483.8
% of Total	(3.0%)	(2.0%)	(2.0%)	(2.0%)	(2.4%)
Nonmetallic Mineral Manufactured	256.8	337.2	403.3	438.0	293.2
% of Total	(2.0%)	(1.7%)	(1.6%)	(1.6%)	(1.5%)
Metal Products	2,899.6	3,304.7	3,506.4	3,939.6	2,746.8
% of Total	(18.0%)	(16.8%)	(14.0%)	(15.0%)	(13.7%)
Machinery & Equip	10,211.5	13,353.1	17,955.4	19,008.3	14,757.9
% of Total	(65.0%)	(68.0%)	(72.0%)	(71.9%)	(73.4%)
Others	1,096.8	1,365.3	1,530.1	1,652.2	1,293.0
% of Total	(6.9%)	(7.0%)	(6.0%)	(6.0%)	(6.4%)

Source: Summary Report Trade of Japan
Japan Tariff Association

US Service Sector Imports from Japan

$ Million

	1970	1971	1972	1973	1974	1975
irect Defense Expenditures	670	614	839	824	758	765
ravel	97	88	121	123	102	131
assenger Fares	70	58	79	86	111	114
ther Transport	277	346	346	467	726	746
ub Total	1,114	1,106	1,385	1,500	1,697	1,756
ees and Royalties to affiliated foreigners	NA	1	1	1	-47	-26
ees and Royalties to unaffiliated foreigners	4	4	6	13	12	9
rivate Payment for other services	22	30	28	49	38	48
SG payments for miscellaneous services	21	18	22	25	29	31
ub Total	47	53	57	88	32	62
ayment of income on Foreign Assets in the US						
irect Investment	21	40	58	22	-99	-38
Interest, dividends, and earnings of uninc. affiliates	NA	NA	NA	NA	NA	NA
Reinvested earnings of incorporated affiliates	NA	NA	NA	NA	NA	NA
ther Private Payments	261	197	205	379	417	323
SG payments	81	306	646	713	713	721
ub Total	363	543	909	1,114	1,031	1,006
otal	1,524	1,702	2,351	2,702	2,760	2,824

ource: Survey of Current Business

US Service Sector Imports from Japan
$ Million

	1976	1977	1978	1979	1980	
					I	IIp
Direct Defense Expenditures	794	823	976	913	195	249
Travel	145	149	155	142	30	64
Passenger Fares	120	122	118	103	32	41
Other Transport	1,159	1,441	1,596	1,926	507	506
Sub Total	2,218	2,535	2,845	3,084	764	860
Fees and Royalties to affiliated foreigners	-34	-34	-69	-94	-24	-26
Fees and Royalties to unaffiliated foreigners	13	16	15	15	4	4
Private Payment for other services	69	70	92	121	32	33
USG payments for miscellaneous services	28	46	43	40	9	9
Sub Total	76	98	116	82	21	20
Payment of income on Foreign Assets in the US						
Direct Investment	94	207	301	510	212	225
Interest, dividends, and earnings of uninc. affiliates	51	44	84	105	58	64
Reinvested earning of incorporated affiliates	43	163	217	405	154	161
Other Private Payments	324	236	422	693	189	195
USG payments	692	797	1,720	1,998	400	399
Sub Total	1,255	1,240	2,443	3,201	801	819
Total	3,404	3,873	5,369	5,867	1,586	1,699

Source: Survey of Current Business

US Service Sector Exports to Japan

$ Million

	1970	1971	1972	1973	1974	1975
Transfer under US military agency	25	42	41	47	48	36
Travel	101	134	205	334	402	410
Passenger Fares	70	104	146	263	364	287
Other Transport	302	350	370	526	655	654
Sub Total	498	630	762	1,170	1,469	1,387
Fees and Royalties from affiliated foreigners	NA	103	114	170	211	223
Fees and Royalties from unaffiliated foreigners	202	225	240	273	249	219
Other Private services	38	58	85	112	89	92
USG Misc. services	23	35	23	66	20	22
Sub Total	263	421	462	621	569	556
Receipt of Income on US Assets Abroad						
Direct Investment	91	149	159	216	226	187
Interest, div, and earnings of uninc. affiliates	NA	NA	NA	NA	NA	NA
Reinvested earnings of inc. affiliates	NA	NA	NA	NA	NA	NA
Other Private receipts	297	267	287	554	1,258	984
USG receipts	29	33	30	27	30	33
Sub Total	417	449	476	797	1,514	1,204
Total	1,178	1,500	1,700	2,588	3,552	3,147

Source: Survey of Current Business

US Service Sector Exports to Japan
$ Million

	1976	1977	1978	1979	1980	
					I	II
Transfer under US military agency	41	40	61	55	11	14
Travel	439	450	539	699	208	190
Passenger Fares	285	300	290	404	115	118
Other Transport	723	885	928	1,180	309	336
Sub Total	1,488	1,675	1,818	2,338	643	644
Fees and Royalties from affiliated foreigners	260	302	453	416	96	101
Fees and Royalties from unaffiliated foreigners	246	275	343	366	98	100
Other Private services	106	99	130	151	41	42
USG Misc. services	23	60	69	27	1	1
Sub Total	635	736	995	960	236	244
Receipt of Income on US Assets Abroad						
Direct Investment	417	572	1,183	872	208	181
Interest, div, and earnings of uninc. affiliates	200	358	499	447	124	147
Reinvested earnings of inc. affiliates	217	214	684	424	83	34
Other Private receipts	797	763	1,204	2,110	814	903
USG receipts	39	44	43	112	39	31
Sub Total	1,253	1,379	2,430	3,094	1,061	1,115
Total	3,376	3,790	5,243	6,392	1,940	2,003

Source: Survey of Current Business

Japan's Service Sector Imports from the United States

$ Million

Japan Service Sector Imports From US	1970	1971	1972	1973	1974	1975
Transportation	1,251	1,475	1,626	2,191	3,668	3,399
Travel	46	375	66	85	114	174
Investment income	57	95	173	343	335	358
Others	575	18	713	1,048	2,149	1,836
Government	19	58	23	19	22	20
Private	711	1,633	1,048	1,357	1,594	1,766
Total	2,659	3,654	3,699	5,038	7,882	7,553

Source: Bank of Japan, Balance of Payments Monthly

Japan's Service Imports from the United States

$ Million

Japan Service Sector Imports From the US	1976	1977	1978	1979	1980
Transportation	3,758	3,861	3,879	5,464	NA
Travel	184	201	244	1,879	NA
Investment income	514	685	1,376	2,130	NA
Others	1,474	1,589	1,476	3,000	NA
Government	51	49	44	53	NA
Private	1,765	1,845	2,197	2,947	NA
Total	7,746	8,230	9,216	15,473	NA

Source: Bank of Japan, Balance of Payments Monthly

Japan's Service Sector Exports to the United States

$ Million

	1970	1971	1972	1973	1974	1975
Japan Service Sector Exports to the US						
Transportation	609	858	979	1,252	2,320	2,445
Travel	39	53	70	70	104	132
Investment income	120	98	117	123	134	129
Others	348	456	912	1,311	1,534	1,538
Government	666	624	715	740	707	735
Private	233	309	323	433	575	667
Total	2,015	2,398	3,116	3,929	5,374	5,646

Source: Bank of Japan, Balance of Payments Monthly

Japan's Service Sector Exports to the United States

$ Million

	1976	1977	1978	1979	1980
Japan Service Sector Exports to the US					
Transportation	2,585	2,760	2,747	3,418	NA
Travel	185	218	274	234	NA
Investment income	157	217	224	3,753	NA
Others	1,474	1,589	1,476	3,000	NA
Government	756	825	971	933	NA
Private	718	814	1,025	1,540	NA
Total	5,875	6,423	6,717	12,878	NA

Source: Bank of Japan, Balance of Payments Monthly

US Japan Bilateral Investment Flows
$ Million (change in assets)

	1970	1971	1972	1973	1974	1975
S assets in Jpn, net(increase/ capital outflow)	636	920	247	2,099	6,314	-1,552
US private assets in Jpn.	647	940	263	2,335	6,324	-1,556
Direct Investment	128	213	226	40	439	-23
Equity and Interco accts.	NA	NA	NA	NA	NA	NA
Reinvested earnings of inc. afiliates	NA	NA	NA	NA	NA	NA
pn Assets in the US	1,101	10,004	5,087	-6882	2,744	-574
Direct Investment	-1	- 512	19	287	231	350
Equity and intercompany acct.	NA	NA	NA	NA	NA	NA
Reinvested earnings of inc. affiliates	NA	NA	NA	NA	NA	NA

Source: Survey of Current Business

US Japan Bilateral Investment Flows
$ Million (stock)

	1970	1971	1972	1973	1974	1975
US assets in Jpn	7,226	8,343	9,843	12,248	18,869	17,337
US private assets	6,553	7,736	8,942	11,613	18,249	16,708
Direct Investment	1,482	1,913	2,323	2,671	3,319	3,339
Jpn Assets in the US	6,049	16,102	21,391	14,503	16,532	16,235
Direct Investment	229	-353	-283	152	345	591
Net bilateral investment position	1,177	-7,759	-11,548	-2,255	1,909	805

Source: Survey of Current Business

US Japan Bilateral Investment Flows
$ Million (change in assets)

	1976	1977	1978	1979	1980	
					I	II p
US assets in Jpn, net(increase/ capital outflow)	605	-541	5,957	5,500	3,333	2,655
US private assets in Jpn.	549	-496	4,294	5,327	3,180	2,564
Direct Invest.	225	344	718	803	421	103
Equity and Interco. accts.	246	130	34	379	338	69
Reinvested earnings of inc. affiliates	NA	214	684	424	83	34
Jpn Assets in the US	3,791	6,329	13,749	-12,074	-539	3,090
Direct Investment	255	587	987	692	171	197
Equity and interco. accts	NA	424	770	287	17	36
Reinvested earnings of inc. affiliates	NA	163	217	405	154	161

Source: Survey of Current Business

US Japan Bilateral Investment Flows
$ Million (stock)

	1976	1977	1978	1979	1980	
					I	II
US assets in Jpn	18,245	17,176	23,107	27,557	NA	NA
US private assets in Jpn.	17,558	16,531	20,870	25,474	NA	NA
Direct Investment	3,797	4,143	4,972	5,775	NA	NA
Jpn Assets in the US	20,506	25,994	40,361	28,299	NA	NA
Direct Investment	1,178	1,755	2,749	3,441	NA	NA
Net bilateral investment position	-2,261	-8,818	-17,254	-733	NA	NA

Source: Survey of Current Business

Japan U.S. Bilateral Investment Flows

$ Million (net)

	1970	1971	1972	1973	1974	1975
Jpn. Long term assets in the US						
Direct Investments	91	53	192	539	492	638
Securities	32	53	313	856	7	-40
Loans	628	23	697	113	-120	-14
Total	300	356	2,113	1,938	493	524
US assets in Jpn.						
Direct Investments	71	167	118	-67	100	93
Securities	27	319	182	-155	-451	107
Loans	80	183	170	21	-82	31
Total	82	589	384	-424	-425	487

Source: Bank of Japan, Balance of Payments Monthly

Japan U.S. Bilateral Investment Flows

$ Million (net)

	1976	1977	1978	1979	1980
Jpn. Long term assets in the US					
Direct Investments	585	470	835	239	NA
Securities	-61	486	1,534	591	NA
Loans	-68	-195	57	-571	NA
Total	374	346	2,634	-2,153	NA
US Assets in Jpn					
Direct Investments	78	43	16	-920	
Securities	171	155	-596	452	
Loans	130	-106	29	-128	
Total	598	361	699	673	

Source: Bank of Japan, Balance of Payments Monthly

World Trade
$ Billion

	1970	1971	1972	1973	1974	1975
Imports, c.i.f.	294.1	328.3	383.6	528.6	774.3	801.3
Exports, f.o.b.	280.0	314.1	372.3	517.8	768.7	788.1
Balance						

Source: UN Monthly Bulletin of Statistics

US International Trade Summary
$ Millions

	1970	1971	1972	1973	1974	1975
Merch. Imports	39,866	45,579	55,797	70,499	103,649	98,041
Merch. Exports	42,469	43,319	49,381	71,410	98,306	107,088
Merch. Trade Bal.	2,603	-2,260	-6,416	911	-5,343	9,047
Service Exports	23,204	25,518	28,906	38,830	48,360	48,642
Service Imports	20,186	20,991	23,639	28,721	33,708	34,795
Service Bal.	3,018	4,527	5,267	10,109	14,602	13,847
US Assets Abroad	-9,336	-12,474	-14,497	-22,874	-34,745	-39,703
For Assets in US	6,359	22,970	21,461	18,388	34,241	15,670
Investment Bal.	-2,977	10,496	6,964	-4,486	-504	-24,033
Current Account	2,330	-1,434	-5,795	7,140	2,124	18,280

Source: Survey of Current Business

Japan International Trade Summary
$ Millions

	1970	1971	1972	1973	1974	1975
Merch Imports	15,006	15,779	19,061	32,576	53,044	49,706
Merch. Exports	18,969	23,566	28,032	36,264	54,480	54,734
Merch.Trade Bal.	3,963	7,787	8,971	3,688	1,436	5,028
Service Exports	4,009	4,840	6,238	8,493	12,031	13,498
Service Imports	5,794	6,578	8,121	12,003	17,873	18,852
Services Bal.	-1,785	-1,738	-1,883	-3,510	-5,842	-5,354
Invest Abroad	-2,031	-2,231	-5,020	-8,468	-4,063	-3,392
For Invest in Jpn	440	1,149	533	-1,282	182	3,120
Investment Bal.	-1,591	-1,082	-4,487	-9,750	-3,881	-272
Current Account	1,970	5,797	6,624	-136	-4,693	-682

Source: Bank of Japan, Balance of Payments Monthly

World Trade
$ Billion

	1976	1977	1978	1979	1980 I
Imports, c.i.f.	911.6	1046.0	1213.4	1522.5	453.6
Exports, f.o.b.	897.5	1018.3	1176.3	1476.1	439.9

Source UN Monthly Bulletin of Statistics

US International Trade Summary
$ Millions

	1976	1977	1978	1979	1980	
					I	IIp
Merch. Imports	124,051	151,689	175,813	211,524	65,002	62,498
Merch Exports	114,745	120,186	142,054	182,055	53,866	56,507
Merch. Trade Bal	-9,306	-30,873	-33,759	-29,469	-11,136	-5,991
Service Exports	56,884	63,890	78,984	104,453	NA	NA
Service Imports	38,197	42,480	54,428	70,113	NA	NA
Services Bal.	18,687	21,410	24,556	34,340	NA	NA
US Assets Abroad	-51,269	-35,793	-61,191	-61,748	NA	NA
For Assets in US	36,518	50,741	64,096	37,575	NA	NA
Investment balance	-14,751	14,948	2,905	-24,173	NA	NA
Current Account	4,384	-14,068	-14,259	-788	-2,453	-738

Source: Survey of Current Business

Japan International Trade Summary
$ Millions

	1976	1977	1978	1979	1980 (Jan-Aug)
Merch Imports	56,139	62,022	71,038	99,387	93,298(1)
Merch Exports	66,026	79,333	95,634	101,232	80,709(1)
Merch. Trade Bal.	9,887	17,311	24,596	1,845	776
Service Exports	14,459	16,277	19,619	25,596	NA
Service Imports	20,326	22,281	27,006	35,068	NA
Services Bal.	-5,867	-6,004	-7,387	-9,472	-718
Invest Abroad	-4,559	-5,247	-14,872	-16,294	NA
For Invest in Jpn	3,575	2,063	2,483	3,676	NA
Investment balance	-984	-3,184	-12,384	-12,618	NA
Current Account	3,680	10,918	16,534	-8,754	-11to -13,000(2)

Source: Bank of Japan, Balance of Payments Monthly
(1) Summary Report Trade of Japan, Japan Tariff Association
(2) Estimate

Total US Imports
$ Million (f.a.s.)

	1970	1971	1972	1973	1974	1975
Imports Total	39,963.2	45,602.1	55,555.2	69,121.2	100,218.1	96,140.4
Agricultural	5,664.9	5,768.1	6,504.9	8,450.0	10,380.1	9,489.8
% of total	(14.0%)	(12.6%)	(11.7%)	(12.0%)	(10.0%)	(9.8%)
Non Agricultural	34,298.3	39,834.0	49,050.4	60,671.2	89,837.9	86,650.5
% of total	(85.8%)	(87.0%)	(88.0%)	(88.0%)	(89.6%)	(90.0%)
Food & Live An.	5,378.9	5,531.2	6,362.0	7,986.2	9,386.2	8,508.8
% of total	(13.0%)	(12.0%)	(11.0%)	(12.0%)	(9.0%)	(8.9%)
Beverages & Tobacco	855.0	875.5	1,009.5	1,213.1	1,322.3	1,419.5
% of total	(2.0%)	(1.9%)	(1.8%)	(1.7%)	(1.0%)	(1.5%)
Crude Materials Except Fuels	3,312.2	3,384.6	3,859.9	4,987.9	6,059.1	5,564.3
% of total	(8.0%)	(7.0%)	(6.9%)	(7.0%)	(6.0%)	(5.8%)
Mineral Fuels, Lubricants & Related	3,080.8	3,714.7	4,798.8	8,101.0	25,427.3	26,475.6
% of total	(7.7%)	(8.0%)	(8.6%)	(11.7%)	(25.0%)	(28.0%)
Oils & Fats-Animal and Vegetable	159.6	171.8	179.6	254.6	544.3	553.9
% of total	(39%)	(37%)	(0.3%)	(0.36%)	(0.5%)	(0.57%)
Chemicals and Related Products	1,450.3	1,612.1	2,015.0	2,436.7	4,017.7	3,696.4
% of total	(3.6%)	(3.5%)	(3.6%)	(3.5%)	(4.0%)	(3.8%)
Manufactured Goods	8,437.4	9,548.5	11,421.6	13,198.3	17,716.3	14,700.5
% of total	(21.0%)	(20.9%)	(20.5%)	(19.0%)	(17.6%)	(15.0%)
Machinery and trans.equip.	11,171.3	13,903.8	17,400.1	20,969.6	24,062.7	23,464.6
% of total	(27.9%)	(30.0%)	(31.0%)	(30.0%)	(24.0%)	(24.0%)
Misc. manufactured goods	4,843.9	5,384.1	6,910.7	8,184.0	9,426.3	9,227.6
% of total	(12.0%)	(11.8%)	(12.0%)	(11.8%)	(9.0%)	(9.6%)
Commodites and Transactions NEC	1,273.8	1,475.8	1,598.0	1,789.8	2,555.7	2,529.1
% of total	(3.0%)	(3.2%)	(2.8%)	(3.0%)	(2.5%)	(2.6%)

Source U.S.Department of Commerce, Bureau of the Census FT 990

Total US Imports
$ Million (f.a.s.)

	1976	1977	1978	1979	1980 (Jan-Oct)
Imports Total	120,677.4	146,816.7	172,025.5	206,326.5	199,989.5
Agricultural	11,178.7	13,538.3	14,960.8	16,881.0	14,359.0
% of total	(9.0%)	(9.0%)	(8.7%)	(8.0%)	(7.2%)
Non Agricultural	109,448.7	133,278.4	157,064.7	189,445.5	185,630.5
of total	(90.0%)	(90.8%)	(91.0%)	(91.8%)	(93.0%)
Food & Live An.	10,267.4	12,490.1	13,520.6	15,170.6	12,935.4
% of total	(8.5%)	(8.5%)	(7.9%)	(7.0%)	(6.5%)
Beverages & Tobacco	1,623.7	1,662.6	2,221.4	2,565.6	2,310.4
% of total	(1.0%)	(1.0%)	(1.0%)	(1.2%)	(1.2%)
Crude Materials Except Fuels	7,013.8	7,944.1	9,333.6	10,650.5	8,768.4
% of total	(5.8%)	(5.0%)	(5.0%)	(5.2%)	(4.4%)
Mineral Fuels, Lubricants & Related	33,996.2	44,286.7	45,105.2	60,060.9	65,959.8
% of total	(28.0%)	(30.0%)	(26.0%)	(29.0%)	(33.0%)
Oils & Fats-Animal and Vegetable	463.9	538.2	511.1	739.8	413.0
% of total	(0.38%)	(0.37%)	(0.3%)	(0.14%)	(0.2%)
Chemicals and Related Products	4,771.8	5,431.9	6,427.4	7,485.0	7,214.3
% of total	(4.0%)	(3.7%)	(3.7%)	(3.6%)	(3.6%)
Manufactured Goods	17,615.2	21,413.9	27,237.3	30,065.1	26,693.8
% of total	(14.6%)	(14.6%)	(15.8%)	(14.6%)	(13.3%)
Machinery and trans.equip.	29,823.9	35,493.7	47,625.6	53,678.4	49,973.7
% of total	(24.7%)	(24.0%)	(28.0%)	(26.0%)	(25.0%)
Misc. manufactured, goods	12,563.9	14,863.6	19,062.1	21,006.0	19,710.5
% of total	(10.0%)	(10.0%)	(11.0%)	(10.0%)	(9.9%)
Commodites and Transactions NEC	2,537.7	2,692.0	3,981.1	4,904.7	6,010.2
% of total	(2.0%)	(1.8%)	(2.0%)	(2.0%)	(3.0%)

Source:U.S. Department of Commerce, Bureau of the Census, FT990

Total US Exports
$ Million (f.a.s.)

	1970	1971	1972	1973	1974	1975
Exports Total	42,593.3	43,497.2	48,876.2	70,223.0	97,143.5	106,156.7
Agricultural	7,173.7	7,694.9	9,409.6	17,676.4	21,996.1	21,889.2
% of total	(17.0%)	(17.0%)	(19.0%)	(25.0%)	(22.6%)	(20.6%)
Non Agricultural	35,419.6	35,802.3	39,466.6	52,546.6	75,147.4	84,267.6
% of total	(83.0%)	(82.0%)	(80.8%)	(74.8%)	(77.0%)	(79.0%)
Food & Live An.	4,349.2	4,365.0	5,665.3	11,930.8	13,983.4	15,486.7
% of total	(10.0%)	(10.0%)	(11.6%)	(17.0%)	(14.0%)	(14.6%)
Beverages & Tobacco	701.7	709.6	908.3	1,008.5	1,247.4	1,309.8
% of total	(1.6%)	(1.6%)	(1.9%)	(1.4%)	(1.3%)	(1.0%)
Crude Materials Except Fuels	4,608.5	4,326.2	5,029.2	8,383.6	10,934.2	9,784.3
% of total	(10.8%)	(9.9%)	(10.0%)	(11.9%)	(11.0%)	(9.2%)
Mineral Fuels, Lubricants & Related	1,594.1	1,497.4	1,553.8	1,670.5	3,442.4	4,464.9
% of total	(3.7%)	(3.0%)	(3.0%)	(2.0%)	(3.5%)	(4.0%)
Oils & Fats-Animal and Vegetable	493.0	615.0	507.2	684.0	1,423.3	943.8
% of total	(1.0%)	(1.0%)	(1.0%)	(0.97%)	(1.5%)	(0.9%)
Chemicals and Related Products	3,826.1	3,837.4	4,133.7	5,748.4	8,822.0	8,750.3
% of total	(8.98%)	(8.8%)	(8.0%)	(8.0%)	(9.0%)	(8.0%)
Manufactured Goods	5,067.0	4,413.0	4,904.0	7,161.3	11,165.9	10,917.7
% of total	(11.9%)	(10.0%)	(10.0%)	(10.0%)	(11.5%)	(10.0%)
Machinery and trans.equip.	17,875.4	19,464.8	21,422.2	27,841.7	38,188.5	45,709.5
% of total	(42.0%)	(44.0%)	(43.8%)	(39.6%)	(39.0%)	(43.0%)
Misc. manufactured goods	2,571.4	2,733.6	3,190.0	3,950.7	5,349.8	5,672.4
% of total	(6.0%)	(6.0%)	(6.5%)	(5.6%)	(5.5%)	(5.0%)
Commodites and Transactions NEC	1,507.0	1,535.2	1,562.6	1,843.5	2,586.6	3,162.3
% of total	(3.5%)	(3.5%)	(3.0%)	(2.6%)	(2.6%)	(3.0%)

Source U.S.Department of Commerce, Bureau of the Census, FT 990

Total US Exports
$ million (f.a.s.)

	1976	1977	1978	1979	1980 (Jan-Oct)
Exports Total	113,323.1	117,962.7	141,154.1	178,578.0	180,857.3
Agricultural	22,996.3	23,671.0	29,406.9	34,745.4	33,180.1
% of total	(20.0%)	(20.0%)	(21.0%)	(19.0%)	(18.3%)
Non Agricultural	90,326.8	94,291.8	111,747.2	143,832.6	145,947.2
% of total	(79.7%)	(79.9%)	(79.0%)	(81.0%)	(81.0%)
Food & Live An.	15,709.7	14,103.4	18,333.2	22,245.4	22,171.5
% of total	(13.8%)	(12.0%)	(13.0%)	(12.0%)	(12.3%)
Beverages & Tobacco	1,523.3	1,846.8	2,292.8	2,336.7	2,124.8
% of total	(1.0%)	(1.6%)	(1.6%)	(1.0%)	(1.2%)
Crude Materials Except Fuels	10,891.4	12,815.2	15,552.8	20,755.3	20,028.0
% of total	(9.6%)	(11.0%)	(11.0%)	(12.0%)	(11.0%)
Mineral Fuels, Lubricants & Related	4,226.1	4,178.9	3,878.3	5,615.9	6,456.1
% of total	(3.7%)	(3.5%)	(2.7%)	(3.0%)	(3.6%)
Oils & Fats-Animal and Vegetable	978.1	1,340.7	1,521.3	1,845.0	1,664.4
% of total	(0.9%)	(1.0%)	(1.0%)	(1.0%)	(0.92%)
Chemicals and Related Products	9,958.2	10,826.6	12,618.4	17,306.2	17,483.2
% of total	(8.8%)	(9.0%)	(8.9%)	(9.7%)	(9.7%)
Manufactured Goods	11,204.8	11,269.5	12,466.0	16,235.7	18,731.1
% of total	(9.8%)	(9.5%)	(8.8%)	(9.0%)	(10.0%)
Machinery and trans.equip.	49,509.9	51,036.5	59,270.3	70,491.4	69,720.9
% of total	(43.7%)	(43.0%)	(41.9%)	(39.0%)	(38.6%)
Misc. manufactured, goods	6,572.3	7,320.7	10,190.9	12,643.0	13,710.6
% of total	(5.8%)	(6.0%)	(7.0%)	(7.0%)	(7.6%)
Commodites and Transactions NEC	2,749.4	3,224.0	5,030.0	9,103.3	7,036.8
% of total	(2.0%)	(2.7%)	(3.6%)	(5.0%)	(3.9%)

Source:U.S.Department of Commerce,Bureau of the Census FT990

Japan's Total Imports
$ Million (c.i.f.)

	1970	1971	1972	1973	1974	1975
Import Totals	18,881.2	19,711.7	23,470.7	38,313.6	62,110.5	57,863.1
Food Stuff	2,574.1	2,917.2	3,607.0	6,009.2	8,122.3	8,814.9
% of Total	(14.0%)	(15.0%)	(15.0%)	(15.7%)	(13.0%)	(15.0%)
Textile Materials	962.7	957.5	1,347.7	2,187.3	1,861.3	1,524.5
% of Total	(5.1%)	(4.9%)	(6.0%)	(5.7%)	(3.0%)	(2.6%)
Metal ores & Scrap	2,696.3	2,527.3	2,487.6	4,033.4	5,328.4	4,416.6
% of Total	(14.0%)	(13.0%)	(11.0%)	(11.0%)	(8.6%)	(7.6%)
Raw Materials	3,017.7	2,915.1	3,356.3	6,038.0	7,189.3	5,718.7
% of Total	(16.0%)	(15.0%)	(14.0%)	(16.0%)	(11.6%)	(9.8%)
Mineral Fuels	3,905.5	4,751.5	5,715.1	8,326.5	24,895.2	25,640.9
% of Total	(21.0%)	(24.0%)	(24.0%)	(22.0%)	(40.0%)	(44.0%)
Chemicals	1,000.5	999.2	1,148.0	1,865.2	2,668.1	2,057.3
% of Total	(5.0%)	(5.1%)	(4.9%)	(4.9%)	(4.0%)	(3.5%)
Machinery & Equip.	2,297.7	2,408.9	2,592.1	3,486.1	4,748.1	4,286.0
% of Total	(12.0%)	(12.0%)	(11.0%)	(9.0%)	(7.6%)	(7.0%)
Others	2,426.7	2,235.0	3,216.9	6,367.8	7,297.7	5,404.2
% of Total	(13.0%)	(11.0%)	(13.7%)	(17.0%)	(11.7%)	(9.0%)

Source: Summary Report Trade of Japan, Japan Tariff Association

Japan's Total Imports
$ Million (c.i.f.)

	1976	1977	1978	1979	1980 (Jan-Aug)
Imports Total	64,799.0	70,808.7	79,343.0	110,672.2	93,298.7
Food	9,375.8	10,105.3	11,403.0	14,415.4	9,364.9
% of Total	(14.0%)	(14.0%)	(14.0%)	(13.0%)	(10.0%)
Textile Materials	1,795.5	2,002.2	2,102.5	2,448.6	1,666.1
% of Total	(3.0%)	(3.0%)	(3.0%)	(2.0%)	(1.8%)
Metal ores & Scrap	4,578.7	4,777.0	4,836.5	6,850.1	5,711.1
% of Total	(7.0%)	(7.0%)	(6.0%)	(6.0%)	(6.1%)
Raw Materials	6,810.8	7,562.9	8,440.9	12,896.9	9,109.4
% of Total	(11.0%)	(11.0%)	(11.0%)	(12.0%)	(9.8%)
Mineral Fuels	28,287.3	31,148.7	31,336.3	45,286.1	46,338.6
% of Total	(44.0%)	(44.0%)	(39.0%)	(41.0%)	(49.7%)
Chemicals	2,661.5	3,003.3	3,763.3	5,178.2	4,170.1
% of Total	(4.0%)	(4.0%)	(5.0%)	(4.7%)	(4.5%)
Machinery & Equip.	4,608.2	4,890.9	6,499.9	8,342.8	6,437.7
% of Total	(7.0%)	(7.0%)	(8.0%)	(7.5%)	(6.9%)
Others	6,681.1	7,318.4	10,960.6	15,254.2	10,501.0
% of Total	(10.0%)	(10.0%)	(14.0%)	(14.0%)	(11.3%)

Source: Summary Report Trade of Japan, Japan Tariff Association

Japan's Total Exports
$ Million (f.o.b.)

	1970	1971	1972	1973	1974	1975
Export Totals	19,317.7	24,018.9	28,591.1	36,930.0	55,535.8	55,752.8
Food Stuffs	647.7	678.7	665.7	841.4	846.3	760.1
% of Total	(3.0%)	(2.8%)	(2.0%)	(2.0%)	(2.0%)	(1.3%)
Textiles	2,407.5	2,772.1	2,995.8	3,278.8	4,064.8	3,718.7
% of Total	(12.0%)	(11.5%)	(10.0%)	(9.0%)	(7.0%)	(6.7%)
Chemicals	1,234.5	1,485.8	1,784.3	2,147.0	4,059.0	3,888.8
% of Total	(6.4%)	(6.2%)	(6.0%)	(5.8%)	(7.0%)	(7.0%)
Nonmetallic Mineral Manufactured	372.4	390.0	478.9	571.3	689.8	729.6
% of Total	(1.9%)	(1.6%)	(1.7%)	(1.5%)	(1.0%)	(1.0%)
Metal Products	3,805.3	4,570.1	4,870.9	6,821.4	13,690.6	12,517.5
% of Total	(20.0%)	(19.0%)	(17.0%)	(18.0%)	(25.0%)	(22.0%)
Machinery and Equip.	8,941.3	11,874.0	15,376.7	20,364.8	27,891.0	30,003.7
% of Total	(46.0%)	(49.0%)	(54.0%)	(55.0%)	(50.0%)	(54.0%)
Others	1,909.0	2,248.2	2,488.9	2,905.4	4,294.4	4,134.5
% of Total	(9.9%)	(9.4%)	(8.7%)	(7.9%)	(8.0%)	(7.0%)

Source: Summary Report Trade of Japan, Japan Tariff Association

Japan's Total Exports
$ Million (f.o.b.)

	1976	1977	1978	1979	1980 (Jan-Aug)
Export Totals	67,225.5	80,494.8	97,543.1	103,031.6	80,708.7
Food Stuffs	886.8	869.6	1,046.9	1,260.8	952.8
% of Total	(1.0%)	(1.0%)	(1.0%)	(1.0%)	(1.2%)
Textiles	4,216.4	4,699.9	4,870.3	4,908.2	3,906.0
% of Total	(6.0%)	(6.0%)	(4.9%)	(4.8%)	(4.8%)
Chemicals	3,747.0	4,299.7	5,102.2	6,100.2	4,508.1
% of Total	(6.0%)	(5.0%)	(5.2%)	(6.0%)	(5.6%)
Nonmetallic Mineral Manufactured	921.3	1,145.5	1,378.7	1,547.1	1,184.7
% of Total	(1.0%)	(1.0%)	(1.4%)	(1.5%)	(1.5%)
Metal Products	13,169.5	14,084.5	16,041.9	18,378.9	13,855.0
% of Total	(19.6%)	(17.0%)	(16.0%)	(18.0%)	(17.2%)
Machinery & Equip	39,626.5	49,744.4	62,510.1	63,182.5	49,703.6
% of Total	(59.0%)	(62.0%)	(64.0%)	(61.0%)	(61.6%)
Others	4,658.0	5,651.1	6,593.2	7,708.0	6,598.6
% of Total	(7.0%)	(7.0%)	(6.8%)	(7.0%)	(8.2%)

Source: Summary Report Trade of Japan, Japan Tariff Association

Total Service Sector Imports into the United States

$ Million

	1970	1971	1972	1973	1974	1975
Direct Defense Expenditures	4,855	4,819	4,784	4,629	5,032	4,795
Travel	3,980	4,373	5,092	5,526	5,980	6,417
Passenger Fares	1,215	1,290	1,596	1,790	2,095	2,263
Other Transport	2,843	3,130	3,520	4,694	5,942	5,688
Sub Total	12,893	13,612	14,992	16,639	19,049	19,163
Fees and Royalties to affiliated foreigners	111	118	155	209	160	287
Fees and Royalties to unaffiliated foreigners	114	123	139	176	186	186
Private Payment for other services	827	956	1,043	1,180	1,262	1,551
USG payments for miscellaneous services	725	746	788	862	967	1,044
Sub Total	1,777	1,943	2,125	2,427	2,575	3,068
Payment of income on Foreign Assets in the US						
Direct Investment	875	1,164	1,284	1,610	1,331	2,334
Interest, dividends, and earnings of uninc. affiliates	441	621	715	699	266	1,046
Reinvested earnings of incorporated affiliates	434	542	569	910	1,065	1,189
Other Private Payments	3,617	2,428	2,604	4,209	6,491	5,788
USG payments	1,024	1,844	2,684	3,836	4,262	4,542
Sub Total	5,516	5,436	6,572	9,655	12,084	12,664
Total	20,186	20,991	23,689	28,721	33,708	34,795

Source: Survey of Current Business

Total Service Sector Imports into the United States

$ Million

	1976	1977	1978	1979	1980	
					I	II
Direct Defense Expenditures	4,895	5,823	7,354	8,469	2,419	2,532
Travel	6,856	7,451	8,475	9,413	2,709	2,483
Passenger Fares	2,568	2,748	2,896	3,106	830	814
Other Transport	6,852	7,874	8,912	10,466	2,835	2,786
Sub Total	21,171	23,896	27,637	31,454	8,793	8,615
Fees and Royalties to affiliated foreigners	293	243	393	471	129	168
Fees and Royalties to unaffiliated foreigners	189	191	214	235	62	63
Private Payment for other services	2,006	2,194	2,566	2,779	733	743
USG payments for miscellaneous services	1,227	1,358	1,545	1,714	418	421
Sub Total	3,715	3,986	4,718	5,199	1,342	1,395
Payment of income on Foreign Assets in the US						
Direct Investment	3,110	2,834	4,211	6,033	1,761	2,077
Interest, dividends, and earnings of uninc. affiliates	1,451	1,248	1,628	2,303	595	957
Reinvested earnings of incorporated affiliates	1,659	1,586	2,583	3,730	1,166	1,120
Other Private Payments	5,681	6,224	9,188	16,361	5,938	5,403
USG payments	4,520	5,540	8,674	11,066	3,053	2,937
Sub Total	13,311	14,598	22,073	33,460	10,752	10,417
Total	38,197	42,480	54,428	70,113	20,887	20,427

Source: Survey of Current Business

Total Service Sector Exports from the US

$ Million

	1970	1971	1972	1973	1974	1975
Transfer under US military agency	1,501	1,926	1,364	2,559	3,379	4,049
Travel	2,331	2,534	2,817	3,412	4,032	4,697
Passenger Fares	544	615	699	975	1,104	1,039
Other Transport	3,125	3,229	3,579	4,465	5,697	5,840
Sub Total	7,501	8,304	8,459	11,411	14,212	15,625
Fees and Royalties from affiliated foreigners	1,758	1,927	2,115	2,513	3,070	3,543
Fees and Royalties from unaffiliated foreigners	573	618	655	712	751	757
Other Private services	1,294	1,546	1,764	1,985	2,321	2,920
USG Misc. services	332	347	357	401	419	446
Sub Total	3,957	4,438	4,891	5,611	6,561	7,666
Receipt of Income on US Assets Abroad						
Direct Investment	8,168	9,159	10,949	16,542	19,157	16,595
Interest, div, and earnings of uninc. affiliates	4,992	5,983	6,416	8,384	11,379	8,547
Reinvested earnings of inc. affiliates	3,176	3,176	4,532	8,158	7,777	8,048
Other Private receipts	2,671	2,641	2,949	4,330	7,356	7,644
USG receipts	909	906	866	936	1,074	1,112
Sub Total	11,748	12,706	14,764	21,808	27,587	25,351
Total	23,206	25,448	28,114	38,830	48,360	48,642

Source: Survey of Current Business

Total Service Sector Exports from the United States
$ Million

	1976	1977	1978	1979	1980	
					I	II
Transfer under US military agency	5,454	7,451	8,240	7,194	1,487	1,458
Travel	5,742	6,150	7,186	8,335	2,339	2,457
Passenger Fares	1,229	1,366	1,603	2,156	606	637
Other Transport	6,747	7,264	8,306	9,793	2,739	2,671
Sub Total	19,172	22,231	25,335	27,478	7,171	7,223
Fees and Royalties from affiliated foreigners	3,531	3,793	4,775	5,042	1,380	1,264
Fees and Royalties from unaffiliated foreigners	822	920	1,065	1,150	307	315
Other Private services	3,584	3,802	4,217	4,291	1,135	1,162
USG Misc. services	489	557	620	522	90	76
Sub Total	8,426	9,072	10,677	11,005	2,912	2,817
Receipt of Income on US Assets Abroad						
Direct Investment	18,999	20,081	25,165	37,815	11,605	7,086
Interest, div, and earnings of uninc. affiliates	11,303	12,795	13,696	19,401	5,945	3,222
Reinvested earnings of inc. affiliates	7,696	7,286	11,469	18,414	5,660	3,864
Other Private receipts	8,955	10,881	15,964	25,861	8,689	9,121
USG receipts	1,332	1,625	1,843	2,294	522	565
Sub Total	29,286	32,587	42,972	65,970	20,816	16,772
Total	56,884	63,890	78,984	104,453	30,899	26,812

Source: Survey of Current Business

Total Service Sector Imports to Japan
$ Million

	1970	1971	1972	1973	1974	1975
Total Service Sector Imports to Japan						
Transportation	2,798	3,006	3,535	5,133	8,087	8,275
Travel	292	395	426	520	730	939
Investment income	315	509	774	1,252	1,358	1,367
Others	919	1,027	1,255	2,165	4,013	3,889
Government	80	58	72	73	78	76
Private	1,390	1,633	1,048	1,357	1,594	1,766
Total	5,794	6,628	7,110	10,500	15,860	16,312

Source: Bank of Japan, Balance of Payments Monthly

Total Service Sector Imports to Japan
$ Million

	1976	1977	1978	1979	1980
Total Service Sector Imports to Japan					
Transportation	9,316	9,787	10,521	14,207	NA
Travel	1,036	1,252	1,465	4,810	NA
Investment income	1,664	2,152	3,717	6,954	NA
Others	3,664	3,623	4,378	9,097	NA
Government	113	138	188	252	NA
Private	4,533	5,329	6,737	8,845	NA
Total	20,326	22,281	26,997	44,165	NA

Source: Bank of Japan, Balance of Payments Monthly

Total Service Sector Exports from Japan
$ Million

	1970	1971	1972	1973	1974	1975
Total Service Sector Exports from Japan						
Transportation	1,635	2,142	2,572	3,437	5,548	6,294
Travel	236	290	381	448	602	784
Investment income	232	122	201	209	235	252
Others	710	980	1,622	2,655	3,562	3,616
Government	692	645	736	765	732	810
Private	504	611	726	979	1,352	1,742
Total	4,009	4,790	6,238	8,493	12,031	13,498

Source: Bank of Japan, Balance of Payments Monthly

Total Service Sector Exports from Japan
$ Million

	1976	1977	1978	1979	1980
Total Service Sector Exports from Japan					
Transportation	7,011	7,489	8,111	9,876	NA
Travel	951	1,116	1,289	554	NA
Investment income	313	425	470	8,965	NA
Others	3,460	3,738	5,278	6,201	NA
Government	876	923	1,162	1,233	NA
Private	1,848	2,586	3,309	4,968	NA
Total	14,459	16,277	19,619	31,797	NA

Source: Bank of Japan, Balance of Payments Monthly

Investment Flows to and From the U.S.
$ Million (change in assets)

	1970	1971	1972	1973	1974	1975
US assets abroad, net (increase/ capital outflow)	9,336	12,474	14,497	22,874	34,745	39,703
Direct Investment	7,589	7,617	7,747	11,353	9,052	14,244
Equity and Interco. acct.	4,413	4,441	3,214	3,195	1,275	6,196
Reinvested earnings of inc. affiliates	3,176	3,176	4,532	8,158	7,777	8,048
Foreign Assets in the US	6,359	22,970	21,461	18,388	34,241	15,670
Direct Investment	1,464	367	949	2,800	4,760	2,603
Equity and interco. acct.	1,030	-175	380	1,890	3,695	1,414
Reinvested earnings	434	542	569	910	1,065	1,189

Source: Survey of Current Business

Investment Flows to and From the U.S.
$ Million (stock)

	1970	1971	1972	1973	1974	1975
US assets abroad	166,764	179,464	199,546	225,167	264,819	295,11
US private assets	118,809	133,134	150,265	171,953	210,584	246,07
Direct Investment	75,480	82,760	89,878	101,313	110,078	124,05
Foreign Assets in the US	97,687	123,329	149,900	163,290	187,414	220,47
Foreign Official assets in US	47,096	52,454	63,167	69,636	80,298	86,85
Other Foreign Assets in the U.S.	50,681	70,875	86,733	93,654	107,116	133,62
Direct Investment in the U.S.	13,270	13,914	14,868	18,284	22,421	27,66
Net international investment position	69,077	56,135	49,646	61,877	77,405	74,63

Source: Survey of Current Business, August, 1980 Table 3. International Investment Position of the US

Investment Flows to and From the U.S.

$ Million (change in assets)

	1976	1977	1978	1979	1980	
					I	II p
S assets abroad, net (increase/ capital outflow)	51,269	35,793	61,191	61,748	12,973	26,650
Direct Invest	11,949	12,898	16,345	24,319	5,685	3,662
Equity and Intercompany acct.	4,253	5,612	4,877	5,904	-197	-548
Reinvested earnings of inc. affiliate	7,696	7,286	11,469	18,414	5,882	4,210
oreign Assets in the US	36,518	50,741	64,096	37,575	7,194	5,760
Direct Investment	4,347	3,728	7,897	9,713	1,166	2,155
Equity and interco. acct.	2,687	2,142	5,313	5,984	500	1,035
Reinvested earnings of inc. affiliates	1,659	1,586	2,583	3,730	1,166	1,120

ource: Survey of Current Business

Investment Flows to and From the U.S.

$ Million (stock)

	1976	1977	1978	1979	1980	
					I	II
S assets abroad	347,174	382,984	450,855	513,192	NA	NA
US private assets	282,418	314,105	377,996	435,795	NA	NA
Direct Investment	36,809	149,848	167,804	192,648	NA	NA
oreign Assets in the US	264,686	310,635	375,519	418,233	NA	NA
Foreign Official assets in US	105,632	141,946	174,832	160,319	NA	NA
Other Foreign Assets in the US	159,054	168,689	200,687	257,914	NA	NA
Direct Investment	30,770	34,595	42,471	52,260	NA	NA
et international investment position	82,488	72,349	75,336	94,959	NA	NA

urvey of Current Business, August, 1980 Table 3. International Investment Position of the US

Total Long Term Investment Flows to and From Japan
$ Million

	1970	1971	1972	1973	1974	1975
Jpn. Long Term Assets Abroad						
Direct Investments	355	360	723	1,904	2,012	1,763
Securities	62	195	1,158	1,787	141	24
Loans	22	594	1,684	3,038	1,136	1,295
Total	2,031	2,231	5,020	8,468	4,063	3,392
Foreign assets in Jpn						
Direct Investments	94	210	169	-42	202	226
Securities	252	940	696	-591	-865	1,578
Loans	65	20	-197	-313	-232	166
Total	440	1,149	533	-1,282	182	3,120

Source: Bank of Japan, Balance of Payments Monthly

Total Long Term Investment Flows to and From Japan
$ Million

	1976	1977	1978	1979	1980
Jpn. Long Term Assets Abroad					
Direct Investments	1,991	1,645	2,371	-2,898	NA
Securities	146	1,718	5,302	-5,865	NA
Loans	1.525	472	6,294	-8,102	NA
Total	4,559	5,247	14,872	717	NA
Total Foreign assets in Jpn					
Direct Investments	113	21	8	239	NA
Securities	1,595	1,256	1,654	2,430	NA
Loans	326	-324	-7	-169	NA
Total	3,575	2,063	2,483	16,294	NA

Source: Bank of Japan, Balance of Payments Monthly

JAPANESE INVESTMENT IN THE UNITED STATES:
AN ANALYSIS OF THE PUBLIC POLICY ISSUES

by

Dr. John Oliver Wilson

JAPANESE INVESTMENT IN THE UNITED STATES: AN ANALYSIS OF THE PUBLIC POLICY ISSUES

Dr. John Oliver Wilson*

I. Introduction

The fundamental nature of the economic alliance between the United States and Japan has evolved over a number of years of working together and a growing mutual understanding of the cultural and political differences between the two countries. As the Japanese economy made a brilliant recovery from the devastating impact of the war this alliance has matured from one of patron-client to that of greater economic equality. In the nineteen-fifties and -sixties the alliance was built upon a military security treaty, the rapid transfer of technology from the United States to Japan, and the expansion of trade between the two countries. By the nineteen-seventies Japan had developed a highly sophisticated and extremely productive economy and trade became even more important in the evolving alliance. The two countries faced problems of learning to cooperate and resolving differences regarding trade flows, current account balances, and foreign exchange. And as we enter the nineteen-eighties the alliance continues to mature, with the area of direct investments between the two countries becoming increasingly important.

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*The author is Director of Economics-Policy Research, Bank of America, San Francisco, and a member of the graduate faculty, Graduate School of Public Policy, University of California-Berkeley. He was assisted in this research by Mr. Michiaki Kumagai, The Sanwa Bank Ltd. Much of the material in the pape is based upon extensive interviews with Japanese businessmen, bankers, and government officials, and so I would like to thank those who patiently answered my many questions.

Japanese investment in the United States became an issue very early in the nineteen-eighties, and was centered around automobiles. With the cost of gasoline rising rapidly, and the American driver becoming increasingly concerned about automobile efficiency, imported automobiles from Japan became very popular. American automobile manufacturers, still locked into their inefficient large and mid-size models, were several years away from producing a high mileage and stylish small car that could compete with the Japanese imports. So the size of the market for Japanese automobiles in the United States expanded significantly.

This expansion was also occurring at a time when the U.S. economy was beginning to slow down, total automobile sales were declining, and the financial difficulties of Chrysler Corporation were receiving a great deal of publicity. As a result some American labor leaders began to "demand" that Japan be forced to invest directly in the United States. The United Automobile Workers union leaders stated that only such direct investment would put back to work the 200,000 or more American workers who were said to have lost their jobs because of automobiles imported from abroad. The Japanese, on the other hand, countered by pointing out that 140,000 Americans were employed in supporting the Japanese imported automobile industry and that economic considerations did not indicate that direct investment in the United States was feasible.

The details surrounding the automobile controversy are related simply to point out the importance, and sensitive nature, of the entire direct investment question. It is not the intent of this paper to engage in a short-run analysis of the issues surrounding automobiles or steel or electronics, to name the most current areas of differences between the United States and Japan. Rather, the paper will attempt to make explicit the basic public policies that seem to be underlying the Japanese and American attitudes regarding direct investment in the United States. In making the policies explicit it is hoped that the degree of understanding, and especially perceptions, between the two countries will be improved. In particular the paper will discuss the following main points:

First, the nature of Japanese direct investments in the United States;

Second, the liberalization of Japanese foreign investment policies;

Third, economic and political forces encouraging direct foreign investment;

Fourth, the role of direct foreign investment in the economic plans of the Japanese government;

Fifth, labor constraints on Japanese investment in the United States; and

Sixth, the threat of protectionism in the United States.

II. The Nature of Japanese Direct Investment in the United States

Historically, the Japanese have not been large direct investors in the United States. At the end of 1979, the Japanese had total investments of just $3,441 million in the U.S., according to U.S. Department of Commerce data.[1] As shown in Table I, the Japanese ranked fifth in the total amount of foreign direct investment in the United States at year end 1979. Netherlands, in the number one position, owned assets of $12,462 million, 3.6 times the assets of the Japanese. The United Kingdom, Canada, and Germany, are all larger investors in the United States than are the Japanese. Indeed, the Japanese own just 6.6 percent of the total foreign direct investments in this country.

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[1] Data from the Ministry of Finance of Japan indicate that the Japanese direct foreign investment totaled $6,050 million at yearend 1978; however, these data include loans which are excluded in the U.S. data. The Japanese data are probably more accurate than the U.S. data, and will be used where feasible throughout this paper. Yet in making comparisons with other nations, we must rely upon the official U.S. data. In addition, neither the U.S. data nor the Japanese data used in this paper include investment by the Japanese in the assets of U.S. corporations, such as the purchase of stocks and bonds. Such financial investments are not addressed in this analysis which is basically concerned with direct real investments.

Table 1

FOREIGN DIRECT INVESTMENT IN THE UNITED STATES
(Position, yearend 1979)

	Millions of Dollars	Percent of Total
Total	52,260	
Netherlands	12,462	23.8
United Kingdom	9,391	18.0
Canada	6,974	13.3
Germany	5,004	9.6
Japan	3,290	6.3
Switzerland	3,441	6.6
France	2,214	4.2

Source: U.S. Department of Commerce, Survey of Current Business, August 1980

There are many reasons for this lack of Japanese investment in the United States. From the end of the Second World War until 1951 direct overseas investment was totally prohibited. By law, Japanese financiers, industrialists, and individuals could not make direct investments in foreign countries. The law was changed in 1951 to allow foreign investment as approved and licensed by the government. Yet there were strong economic forces which encouraged direct investment within Japan rather than in the U.S. Labor costs were significantly lower in Japan. The Japanese had less developed technology than did the U.S., and there was a scarcity of managerial resources among Japanese firms. These economic forces encouraged the Japanese to emphasize exports in their economic development rather than direct investments abroad.

The nature of these economic growth policies not only tended to minimize the amount of direct investment by the Japanese in the United States, it also greatly influenced the type of investments that were made. Nearly three-quarters of the total Japanese direct investment in this country during the post-war era was in commercial, financial, and other non-manufacturing activities. (See Table 2.) The Japanese trading companies established their overseas offices and subsidiaries that were needed for the conduct of their growing international business. Manufacturing companies set up sales networks, service offices, and distributing systems in their foreign markets. And as this international business expanded, Japanese banks went abroad in order to meet the home-based companies' financial needs. Only $995 million out of the total $7,139 million of direct foreign manufacturing investments made by the Japanese during the post-war era was located in the United States. And just $337 million out of a total $5,869 million of foreign direct investment in natural resources was located in this country.

Table 2

JAPANESE DIRECT FOREIGN INVESTMENT BY TYPE OF INVESTMENT
(Includes loans, fiscal year basis, millions of dollars)

Total investment made during 1951 to 1977

	Worldwide	Percent of total worldwide	United States	Percent of total U.S.
Manufacturing	$ 7,139	32.2	$ 995	20.9
Development of natural resources	5,869	26.4	337	7.1
Commerce, finance, and other non-manufacturing	9,203	41.4	3,435	72.0
Total	22,211	100.0	4,767	100.0

Source: Ministry of Finance of Japan.

In recent years, these historical trends have begun to change. The Japanese are beginning to invest at a far greater rate in the United States than in the past, and at a somewhat greater rate than are other industrialized nations. From 1951 through 1964, for instance, Japanese direct investments in the U.S. averaged only $13.4 million a year. (See Table 3.) From 1965 through 1969 such investments averaged just $84.2 million a year. Then when the nvestment policies of the Japanese government became more liberal, and economic orces turned more favorable to investment abroad, average annual investments ncreased to $393 million. And in recent years, they have been averaging close o a billion dollars a year.

Table 3

AVERAGE ANNUAL JAPANESE FOREIGN DIRECT INVESTMENT
(Includes loans, fiscal year basis, millions of dollars)

	Worldwide	United States	U.S. as percent of worldwide total
1951 = 1964	$ 56.4	$ 13.4	23.8
1965 - 1969	376.6	84.2	22.4
1970 - 1974	1,997.8	393.0	19.7
1975 - 1978	3,536.5	869.3	24.6

Source: Ministry of Finance of Japan.

During the past five years, Japan has been second only to the Netherlands in the growth of direct investments in the United States. Most of this investment continues to be in commercial, financial, and other non-manufacturing areas. In a study made in the early nineteen-seventies of the motivation for Japanese firms for investing abroad, 77 percent of all manufacturing firms stated that their primary objective was foreign sales. Of these firms, 37 percent indicated that their aim was to export machines, equipment, and materials to a foreign subsidiary or branch; 29 percent located in a foreign country to defend already established markets; and 34 percent viewed foreign investment as an opportunity to develop new markets.[2] While the Japanese have rapidly increased the level of their investments in recent years, there has been little change in the basic nature of those investments. The United States continued to be a large market for the sale of Japanese exports, and not a significant area for the location of manufacturing facilities.

The United States has been an attractive location for foreign investments in recent years for several reasons: (1) The U.S. economy expanded more rapidly from the 1974-75 recession than did the economies of most other countries; (2) the depreciation of the U.S. dollar against a number of leading foreign currencies since 1971 has made investment attractive; (3) costs of production in the U.S. have declined relative to such costs in other major industrialized countries; (4) high interest rates in the U.S. has encouraged the use of equity and inter-company account inflows rather than funds borrowed in U.S. financial markets; and (5) the political stability of the United States has greatly encouraged the expansion of foreign direct investment. The Japanese have been expanding their investments in the United States to take advantage of these conditions along with other industrialized nations. In addition Japanese investment was encouraged by (6) the accumulation of foreign reserves resulting from a sizable surplus on balance-of-payments; and (7) the Japanese government's liberalization of policies regarding direct foreign investment.

III. The Liberalization of Policies Regarding Japanese Direct Foreign Investment

The basic law that guided policies involving Japanese direct foreign investment during most of the post-war era is the Foreign Exchange and Foreign rade Control Law of December 1, 1949, which clearly set forth the following conomic goals:

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[2] H. Robert Heller and Emily E. Heller, Japanese Investment in the United States (New York: Praeger Publishers, 1974), pp. 42-47.

> The purpose of this Law is to provide for the control of foreign exchange, foreign trade and other foreign transactions, necessary for the proper development of foreign trade and for the safeguarding of the balance of international payments and the stability of the currency, as well as the most economic and beneficial use of foreign currency funds, for the sake of the rehabilitation and the expansion of the national economy.

There are several significant points to be made regarding this law, and particularly as the law has been interpreted and administered during the past thirty years. In the first place, Japanese policies relating to direct investment must be understood in the context of the total policy of Japan regarding all economic interactions with foreigners. There does not exist a public policy for direct foreign investment out of context of total Japanese foreign economic policies. Second, Japanese foreign policies are closely integrated with domestic economic policies, and in particular, industrial development policies. Third, Japanese foreign economic policies are very much determined by administrative interpretation of the law, rather than the basic premises stated in the law.[3] And finally, the Japanese government can discourage direct foreign investment through licensing restrictions or encourage investment through economic incentives. It cannot control the amount of investment which Japanese firms make, for that is essentially a private business decision influenced primarily by economic factors.

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[3] While it is true that the basic law controlling international transactions, including foreign investment, is "The Foreign Exchange and Foreign Trade Control Law of December 1, 1949," there are several levels of regulations other than "the law" in the Japanese legal system. The second level of regulation of the basic law is the so-called Cabinet Order (or governmental regulation) which is established by the Cabinet based on trust of the law. The third level of regulation is the so-called Ministerial Ordinance, which is the administrative details of the law by the specific Ministry in charge of the law. During the past thirty years, several steps were taken towards the liberalization of direct investment abroad by changes in the Cabinet Order or Ministerial Ordinance, and not only by changes in the interpretation of the basic law itself.

With the enactment of the law in 1949 until the mid-1960s, Japanese foreig economic policies were under rather strict government restraint. The Foreign Exchange and Foreign Trade Control Law was fully prohibitive or restrictive in many cases of international transactions. The law granted to the Cabinet the authority to require the sale to, or deposit of, all foreign means of payment as well as precious metals with the Bank of Japan or its agents and expressly prohibited all payments between residents and nonresidents without authorizatio The law was also restrictive regarding foreign investment, expressly forbidding any transactions in foreign assets, securities, or immovables without governmen approval.

In practice Japanese citizens and corporations had to apply to the Ministe of Finance or the Bank of Japan for approval to invest abroad. The Minister of Finance was responsible for issuing licenses to private individuals for the acquisition of securities in new or established companies, for the purchase of real estate, and for the granting of loans or credits, as well as regulating the payments for licenses or technological assistance. The Bank of Japan administered the law regarding applications for the establishment of overseas branches or representatives offices. These administrative practices gave the government of Japan direct control in restricting foreign investments, yet the control did not extend to increasing such investments. Since Japan has an essentially free enterprise economy, the amount of foreign investment abroad remains basically a private business decision.

Beginning in 1967, however, economic forces started to build that led to a significant liberalization in the implementation of the Foreign Exchange and Foreign Trade Control Law. Japan began to earn a sizable surplus on the goods and services balance, exporting over $2,000 million more than they imported. These surpluses greatly added to their accumulation of international reserves which expanded from $2,030 at the end of 1967 to $4,840 by the end of 1970.

The liberalization of policies regulating Japanese direct foreign investment began in 1969 and was phased in gradually during the next four years. From 1969 through 1972 these policies underwent their most significant change in the post-war era.

The first step in liberalization was taken on October 1, 1969, when automatic approval was granted for certain categories of direct investment that satisfied the following requirements: (1) the level of the investment did not exceed $200,000; (2) the Japanese investors held 25 percent or more of the stocks in the proposed investment; and (3) one or more executive officers should be sent to help manage the investment abroad. However exempted from automatic approval were investments in real estate, selected categories of fisheries, pearl farmings, banking industry or securities firms, industries in probably international or diplomatic problems, and industries which might have substantial negative effects on the Japanese economy.

Clearly this liberalization step was far different from the "open-door" policies that prevailed in most western industrialized countries, and particularly, in the United States. The Japanese government still retained some restraint over direct investments abroad, for the definition of industries in probable international or diplomatic problems, as well as those that might have a substantial negative effect on the Japanese economy left a great deal of latitude for administrative discretion. The actual impact of the Japanese Foreign Exchange and Foreign Trade Control Law was as much determined by administrative interpretation as by legislated principles. It was how the law was actually administered, moreso than what the law stated, that really determined the investment policies of Japan. Yet this first liberalization step made a significant break with the past. It introduced the idea of "automatic approval" for applications for direct investments abroad. This automatic approval was to remain the key feature of all subsequent liberalization steps.

The second step in liberalization was taken on September 1, 1970, when the ceiling for automatic approval was increased to $1,000,000. The same six categories of industries were excluded from this automatic approval process as in step one of liberalization and to receive automatic approval a proposal for direct investment abroad had to ensure either: (1) One-half or more of the stock in the investment would be owned by Japanese investors; or (2) One-quarter to one-half of the stock must be held by Japanese investors and one or more Japanese executive officers should be sent to manage the company.

The third step in liberalization was taken on July 1, 1971, when the ceiling for automatic approval was totally removed. Now there was no maximum limit on the size of the investment that would receive automatic approval, provided that the investment did not fall into one of the categories of excluded investments as in earlier liberalization steps. Also there was a significant liberalization in the additional conditions required for automatic approval. Rather than requiring one-half or more of the stock to be owned by Japanese investors, the new legislation required only 25 percent Japanese ownership. The Japanese participation could be as low as 10 percent, provided that one of the following conditions was satisfied: (1) One or more Japanese executive officers should be sent to manage the investment; (2) agreements on providing technologies exist; (3) agreements on supplying materials exist; (4) aggreements on the purchase of products exist; (5) agreement on financial help exist; or (6) agreement on sole agent exists.

It was in this third step that the Japanese liberalized the procedures for investing in real estate abroad. (Real estate investment had continued to be greatly restricted throughout the earlier liberalization steps.) With the new changes all applications for the acquisition of real estate in a foreign country would be automatically approved provided that the purpose of acqusition would be for such "real needs" as living use, office space, warehousing, or showrooms. But if the purpose of the acquisition was for resale (for presumed speculative capital gains) or renting the application would not be automatically approved. It was more likely to be rejected.

The fourth step in liberalization, taken on June 8, 1972, added very little to those conditions that existed with the third step. In fact the only change affecting non-real estate investment was to add a seventh additional condition to the list applicable to investments with 10 to 25 percent Japanese ownership. This seventh condition stated that Japanese investors should establish a permanent economic relationship with the foreign company. Real estate investment was further liberalized as the "real need" condition was eliminated, and the basic policy was automatic approval of all real estate investments abroad.

The final step in liberalization was taken on April 1, 1978. This final liberalization provided that applicants for direct investment should send only written notices to the Bank of Japan instead of getting automatic approval from the bank.

Then in December, 1979, Japan adopted substantial amendments to its basic Foreign Exchange and Foreign Trade Control Law of December 1, 1949. Reputed to be the most significant statutory changes in Japanese foreign investment laws in the past thirty years, the new amendments will go into effect around December, 1980, after the development and adoption of necessary implementing regulations.

The spirit of the new law is set forth in Article 1, which provides that it is the "basic principle" that foreign transactions be carried out "without restraint and by exercising minimum control." This is a major shift from previous policies, which were based on the basic principle that all investments must be approved in advance. Even during the liberalization of the law, this principle still applied for the government authorized automatic approval for certain categories of investment, but never gave up its basic authority of approval.

The definition of direct foreign investment in the new law, called "capital transaction," includes the following transactions between Japanese and foreigners:

(1) Deposits;

(2) Loans;

(3) Transfers of notes, money, bills of exchange and letters of credit;

(4) Guarantees;

(5) Issuance or floatation of securities;

(6) Acquisition of securities;

(7) Acquisition of real property; and

(8) Transfers of capital between a foreign office and an office in Japan.

Certain of these categories of capital transactions must still receive prior authorization from the government. These include deposits; transfers of notes, money bills of exchange and letters of credit; and issuance or floatation of Yen dominated securities by nonresidents.

The major forms of direct investment abroad, i.e., loans, guarantees, acquisition of securities, and the issuance or floatation of securities abroad by Japanese corporations, must be reported to the Minister of Finance. The Japanese investor must then wait 20 days after filing the report before carrying out the proposed transaction. During this time the Minister of Finance may examine the proposed investment, and he may then recommend modifications or cancellation. The proposed investor then has 10 days within which to notify the Ministry whether he will comply with the recommendation. If he refuses to comply, the Minister of Finance has an additional 20 days to decide whether to order compliance.

The Minister of Finance can recommend modifications or cancellation of any proposed investment if he determines that such an investment would have an adverse effect upon: (1) international financial markets; (2) Japanese financial or capital markets; (3) the business activities of certain Japanese industries; or (4) treaties or international agreements by which Japan is bound.

Obviously the Minister of Finance has a great deal of discretion in administering the new law. While the direct restraint of the past is gone, either explicitly as practiced from 1949 through 1969 or implicitly as practiced from 1969 through 1979, the Japanese government has retained the power to influence. While the new law is not a complete liberalization of foreign investment policies, it would be fair to characterize the law as marking the end of the era of "power to restrain" foreign direct investment and ushering in a new era of "power to influence" such investment.

It seems fairly clear that the Japanese have entered a new stage in their economic development in which direct foreign investments will play a much larger role than in the past. The increase in their investments in recent years certainly supports this view. The fact that they have significantly amended their Foreign Exchange and Foreign Trade Control Law, adopting the principle that foreign transactions be carried out without restraint and with minimum control, gives legislative credence to this fact. And Japanese business leaders and government officials are quite open in their general belief that increased direct foreign investments must play a much greater role in the future. Yet the extent to which such investments will expand will be influenced by four factors:

> First, the existence of strong economic and political forces operating to encourage an expansion of Japanese direct foreign investment;
>
> Second, the role of direct foreign investment in the future economic plans of the Japanese government;
>
> Third, the existence of certain social and economic forces operating to discourage direct foreign investment;
>
> And fourth, the possible rise of protectionism in the United States.

IV. Economic and Political Forces Encouraging Direct Foreign Investment

A number of economic and political forces are operating to encourage the expansion of Japanese direct foreign investment in the future.[4] The first of these forces is the pressure to assume a larger and more significant role in the world economy; a role that matches the size and strength of their national economy. Japan has the second largest economy in the free world; second only to the United States. In 1978, for instance, the gross national product of Japan was $967 billion, well beyond the $640 billion in West Germany or $470 billion in France. Japanese industries are among the largest in the world. The Japanese automobile industry is now producing twenty percent of all new cars in the world, and exporting over four times as many new automobiles as does Detroit. In computers, television sets, sound equipment, capital goods, and numerous other products the Japanese industrialists have become major producers on a global scale. Toyota Motors is the third largest automobile manufacturer in the world. Matsushita Electric, Nisson Motors, Mitsuhishi Heavy Industries, along with a dozen other Japanese firms, would rank among the Fortune top 100 firms in the United States in terms of size.

Yet for all of their enormous size and economic power, the Japanese have tended in the past to view themselves as a somewhat "struggling industrial power." They had to completely rebuild their industrial base following the end of the Second World War, they inhabit a small geographic area that lacks natural resources, and they are totally dependent upon imported oil. All of these conditions have perpetuated a psychological sense that Japan is a highly vulnerable and fragile economic power living in the shadow of the United States. This relationship, as noted in the introduction, has greatly altered in recent years, and the Japanese are beginning to perceive the extent of their economic power and their inherent strength. This is quite clear in statements contained in the New Economic and Social Seven-Year Plan to be discussed in detail later. It is also clear in discussions with Japanese leaders. There is a growing sense among the Japanese of the true power of their nation in the global economy, and a recognition that to continue to operate and expand in the large and affluent economic markets of the United States and Western Europe that they must begin to expand far more directly into those markets other than through exports and trading company activities.

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[4] These forces were those most frequently emphasized during my interviews with business, financial, and government leaders in Japan during May, 1980, when I was researching this paper. Most of the observations in the remaining sections of this paper are based on extensive interviews, reviews of the major planning documents of the Japanese government, and indepth discussions with many of the government officials who were responsible for preparing these documents.

These markets, of course, could continue to be served through direct exports. This has been the tradition in the past. Manufacturing facilities have been built in Japan, where labor quality and labor relations are minimal problems, or in southeast Asian countries where relative labor costs are low, and the products have been exported to the United States markets. Yet there is a second force that is operating with increasing influence to limit the continued growth of export markets, and that is a perceived threat of protectionism. The Japanese feel that protectionist sentiment is growing in the United States. They are concerned that to continue to expand exports to this country could well lead to formal trade barriers in the form of increased tariffs, quota limitations, or agreements to restrict trade. And if formal trade barriers are not erected, they clearly sense the danger of growing union antagonism against Japanese imports.

Whether there is a significant and serious increase in protectionist sentiment in the United States will be discussed later. It may simply be a passing phase, highlighted by the presidential election and the ongoing structural adjustments in the American automobile industry. Yet the fact that it has erupted so strongly and visibly will make the Japanese increasingly sensitive to the need to expand their direct investments in the United States.

A third factor that is operating to encourage direct foreign investment in the United States is the closing of the gap in manufacturing labor costs. In the past, labor costs in the United States far exceeded those in Japan as shown in Table 4. During 1970, for instance, the average hourly earnings for an employee in manufacturing in Japan was $1.07, compared to an hourly wage of $3.35 in the U.S. By 1979, this gap had closed to the point where hourly earnings of Japanese workers were equal to 87 percent of those in this country. It is particularly interesting that the gap in labor costs has closed in such industries as steel, automobiles, and electronics, for these are the industries where major policy differences occur between Japan and the United States.

These comparisons do not take into consideration fringe benefits, which are greater for Japanese than for American workers. If accurate comparisons could be made, including all fringe benefits as well as direct wages, it is likely that the Japanese worker would cost more than a comparable American worker.[5] It is clear that it is no longer nearly as economical to produce in Japan, at least as measured by wage rate differentials, as it was in the past.

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[5] Comparisons in labor costs are very difficult to make, especially between two countries where social and economic differences are as great as between the U.S. and Japan. To simply include the estimated market value of such standard fringe benefits as health insurance, pensions, etc., is not sufficient. The Japanese workers enjoy far greater job security, including an implicit understanding of life-time employment, than does his or her counterpart in the United States. This security represents a significant fringe benefit that adds to the labor costs of Japanese firms, but which is difficult to measure. In addition, Japanese management would probably consider American labor less productive, certainly less manageable, than Japanese labor. Consequently, the apparent reduction in the wage differential gap may not be viewed as significant by the Japanese as the numbers indicate.

Table 4

U.S. AND JAPANESE MANUFACTURING LABOR COSTS
(nominal average hourly earnings in Japan as
percent of those in the United States)

	Total Manufacturing	Steel	Automobiles	Electronics
1970	31.9	36.9	29.4	30.2
1979	87.3	85.8	75.5	88.6

Source: U.S. Department of Labor, Bureau of Labor Statistics, and Bank of Japan, "Economic Statistics Monthly."

The Japanese have long been sensitive to their lack of natural resources, and the oil crisis of recent years has greatly intensified this concern. As a fourth factor this lack of natural resources will operate to encourage direct foreign investment in the future. Japanese manufacturers will begin to locate their production facilities in those countries where they think that natural resources are relatively plentiful and secure. Such a country is the United States. Our large and secure supplies of natural resources--including agriculture products, metals, and particularly coal--will play an increasing role in influencing the Japanese to locate their plants in this country.

The availability of natural resources will reverse a trend in direct foreign investment that has existed for the past several decades. The Japanese have traditionally located their heavier production facilities in Japan or other countries in Asia and exported to the United States. Only their trading companies, financial institutions, and some light manufacturing activities were located in this country. But now they will begin to locate heavier production facilities in the United States. (There will probably be some significant exceptions to this general trend, including automobiles, steel, and ship building facilities. These exceptions have to do with certain social and economic forces operating to discourage direct foreign investment in the United States, and will be discussed later.)

A fifth factor that will encourage the expansion of direct foreign investment in the United States is that of political stability. As one Japanese business leader expressed it: "We may not understand your political process and always agree with the positions of your political leaders, but at least we can be certain we will not be expropriated."

At a time of increasing political unrest in many parts of the world, the political stability of the United States becomes an increasingly attractive feature of investing in this country. This is particularly true as the Japanese begin to feel some coolness or even backlash against continued expansion in southeast Asian countries where a large part of their direct investment occurred in the post-war era. Japanese leaders feel that they are no longer as welcome in the developing countries of southeast Asia, and therefore they have no alternative but to invest in the developed and industrialized nations of the world where the receptivity is better.

The relative importance of these factors in encouraging Japanese firms to expand their investments abroad is evident from a recent survey made by the Ministry of International Trade and Industry (MITI) in Japan. MITI surveyed a number of Japanese business and industrial leaders to determine what were the most important reasons for planning to invest abroad in the future. The results are shown below for investment in both developed and developing countries.[6]

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[6] Ministry of International Trade and Industry, Government of Japan.

Table 5

REASONS FOR INVESTMENT IN DEVELOPED COUNTRIES
(percent of firms responding positive)

Reason	Percent positive response
I. Companies Now Invested Abroad	
Diversification and internationalization of business activity	78.2
The threat of trade barriers and overcoming non-tariff barriers	34.5
To secure raw materials needed for production	16.4
To take advantage of investment incentives	9.1
II. Companies Planning to Invest Abroad	
Diversification and internationalization of business activity	65.0
The threat of trade barriers and overcoming non-tariff barriers	60.0
To secure raw materials needed for production	30.0
To take advantage of lower production costs other than than labor costs	15.0

Note that the diversification and internationalization of business activity is the single most important reason for investing abroad both by firms that have already made their investment decision, and those firms which are planning to invest abroad. But among the latter group of firms, the threat of trade barriers and overcoming non-tariff barriers has become a consideration that is almost as important as that of diversification. The threat of trade barriers did not operate to nearly the extent for firms that made their investment decisions in the past. Clearly Japanese firms are being influenced in their investment decisions by the threat of protectionism.

It is interesting to compare these reasons with those for investing in developing countries. As shown by the data in Table 6, diversification of business activity is the single most important reason for investing abroad in developing as well as developed countries. It is also interesting to note that the closing of the gap in relative labor costs in developed countries has significantly reduced costs as a consideration for investing in developing countries. Companies which made their investment decisions in the past responded that labor costs were the most important reason for such a decision (67.9 percent positive response). But firms considering new investments in the future rate lower labor costs as third in importance (42.6 percent positive response).

Table 6

REASONS FOR INVESTMENT IN DEVELOPING COUNTRIES
(percent of firms responding positive)

Reason	Percent positive response
I. Companies Now Invested Abroad	
To take advantage of lower labor costs	67.9
Diversification and internationalization of business activity	53.1
To take advantage of investment incentives offered by the governments of developing countries	51.9
To take advantage of export incentives of the developing countries	24.7
The threat of trade barriers and overcoming non-tariff barriers	23.5
II. Companies Planning to Invest Abroad	
Diversification and internationalization of business activity	53.7
To take advantage of investment incentives offered by the governments of developing countries	44.4
To take advantage of lower labor costs	42.6
To secure raw materials needed for production	24.1
The threat of trade barriers and overcoming non-tariff barriers	24.1

In summary, it is clear that there are several very strong and powerful factors that are operating to encourage Japanese business and industrial leaders to expand their direct investment in the United States. Yet it would be misleading to assume that the Japanese will pursue direct foreign investment with the same vigor as they have shown in expanding foreign trade. The Japanese will probably undertake direct foreign investment slowly and conservatively. They will not become the aggressive foreign investors as did the Americans or Dutch or British in years past. Nor will they necessarily respond as rapidly to purely economic incentives as westerners might think they should. The Japanese will carefully measure the economic risks against the economic benefits and respond slowly to political pressures. Furthermore, the extent to which direct foreign investment becomes a major new thrust in the future economic development of Japan depends upon two additional factors: The official policies of the Japanese government, and the degree to which Japanese manufacturers overcome certain social and economic constraints, particularly their reluctance to encounter western labor and labor unions.

V. Role of Direct Foreign Investment in the Economic Plans of the Japanese Government

It is evident in government documents and discussions with government officials that direct foreign investment is expected to be more important in the future development of the Japanese economy. The New Economic and Social Seven-Year Plan, published by the government of Japan in August 1979, for instance, gives some indication of the direction of government planning. In the section entitled "Development of Investment Activities Overseas," the plan states:

> While promoting the appropriate development of investment overseas, efforts will be made to develop the economy and encourage the trade of the host country through joint transfers of capital and technology. In conjunction with these efforts, in order to contribute to the smooth restructuring of Japan's trade and secure stable supplies of resources and energy, the necessary guidance and assistance will be given to such areas as large-scale economic cooperation projects, resource development, and investment overseas by smaller enterprises.

A far stronger policy position is stated in a paper prepared by the Ministry of International Trade and Industry entitled "The Vision of MITI Policies in 1980s." In discussing new national goals, the MITI paper states:

> The Japanese economy has attained the national goal of the past hundred years, reaching the level of Western industrial nations. It is time for Japan to establish new national long-term goals and to envisage the course to reach them. We propose the following three national long term policy goals.
>
> (1) Contributing positively to the international community.
> (2) Overcoming the limitations of natural resources and energy.
> (3) Attaining co-existence of dynamism of the society and the improved quality and comfort of life.

"Japan now has a strong influence in the international economy," the paper continues when discussing the need to build a reputation for trustworthiness. "In the 1980s and beyond, Japan must contribute as much as possible to laying the foundations for the maintenance of world peace and the development of the world economy. Japan should, for example, play its part in the maintenance of the free trade system, play a larger role in the concerted efforts by developed nations in the technological research and development, and continue steadily the economic cooperation for developing countries. The general populace must be willing to accept these responsibilities."

And finally, the paper sets down the specific reasons why Japan must promote direct investment in overseas markets:

> Direct overseas investment, which is expected to expand further in the coming decade, is valuable for the following requirements:
>
> (1) to sophisticate the domestic industrial structure and to promote international division of labor;
>
> (2) to promote international communication through exchanges of people and transfer of particular corporate activities to foreign countries;
>
> (3) to promote the transfer of management resources and job opportunities;

(4) to secure stable supply of energy and resources; and

(5) to consolidate the management of Japanese firms.

Points (2), (3), and (4) are fairly straightforward, and simply recognize the reality of the economic and political forces discussed earlier that are operating to encourage the expansion of Japanese direct foreign investment in the future. Points (1) and (5), however, seem to be somewhat ambiguous in their meaning. After lengthy discussions with MITI officials, it became clear that "to sohpisticate the domestic industrial structure" refers to a continuation of the positive adjustment of Japanese industry to the evolving international economic markets. This positive adjustment has been practiced by the Japanese for some years, as they spin off less sophisticated industries and develop those that are more sophisticated, such as the well-known move from textiles to electronics. They simply intend to continue this process.

"To consolidate the management of Japanese firms," point (5), took on quite a different meaning when this goal was reinterpreted by MITI officials. A more appropriate interpretation might be to "provide a better foundation or basis for the growth of enterprises." This foundation apparently means the internationalization of Japanese companies.

Yet this move towards greater internationalization raises a number of basic issues among government officials. It is well recognized that internationalization means the development of multinational companies which have the ability to move capital, goods, and services across geographic and national boundaries almost at will. The development of truly multinational companies in Japan means that the government will have far less influence over economic conditions and economic planning in general, _if_ the occasion should ever arise that more influence is desired. If the economic situation should deteriorate so that a return to the more direct controls of the past was deemed appropriate, the existence of strong and independent multinational companies makes the imposition of controls more difficult. The debate in the United States over how to control multinational corporations has not gone unnoticed among government officials in Japan.

VI. Labor Constraints on Japanese Investment in the United States

Labor concerns are of two types: First, the likely reaction of labor unions within Japan to the location of jobs abroad; and second, the attitude of Japanese management to American labor and labor unions.

It would seem reasonable to expect that Japanese labor unions would be watching the movement of Japanese investments abroad with some caution, since the location of manufacturing facilities in the United States means that American workers will have those jobs and Japanese workers will not. Yet this does not mean that there will be an automatic reduction in Japanese employment as a result of foreign investment. If the investment represents growth in Japanese markets that would not otherwise have occurred, then there is no loss of Japanese jobs. On the other hand, if production in the United States represents a direct one-to-one substitution for potential exports from Japan, then there will be a loss of jobs for Japanese labor.

The actual outcome will lie between these two extremes. Certainly some of the production in the United States will come at the expense of potential growth in export markets, particularly if the United States should adopt protectionist policies regarding selected Japanese imports, such as automobiles. Yet the Japanese will continue to expand their export markets in this country, for they are highly efficient, they produce good quality products that appeal to the American consumer, and they have rapidly mastered western advertising methods. The economic arguments in favor of continued expansion of Japanese export markets is very great.

It is in considering the interplay between these two forces--protectionist entiment and economics--that may have dampened any Japanese labor union eaction against the liberalization of government policies on direct foreign nvestment. In fact it is interesting to note that the union leaders representing oyota Motors employees are advocating the placement of Toyota manufacturing cilities in the United States, whereas the senior management of Toyota pparently is far more reluctant about making this investment. Although we do t know the real motives behind the position of the labor leaders, it is not reasonable to assume that they view a strong anti-direct investment position the part of Toyota could lead to marketing agreements or even direct quotas the number of Toyota vehicles that can be exported to U.S. markets. The sult of such protectionist actions might lead to a smaller total market for yota vehicles, and therefore less jobs in Japan. It is far better to buy a ttle "insurance" against this possibility, and locate a few thousand jobs in e United States.[7]

Unless the size of direct foreign investment grows far more rapidly than ticipated, or the Japanese economy suffers a much higher level of unemploy-nt than is foreseen, the attitude of labor within Japan is likely to be a nor constraint on investment abroad. The major labor issue does not lie th Japanese labor, but with American labor. It is the quality of American bor, and the strength of American labor unions, at least as perceived by panese business leaders, that will prove to be the most serious of the social d economic constraints.

According to Weekly Oriental Economist (one of the most influential economic magazines in Japan), Mr. Ichiro Shiozi, the Chairman of the Federation of Automobile Labor Unions, which organizes 600,000 automobile workers, made a speech at the Central Committee of Feb. 1, 1980. He said that it is good for the Japanese automobile industry to build manufacturing facilities in the U.S. Toyota and Nissan should have factories there. Mr. Shiozi promoted the visit of Mr. Frazer, Chairman of the UAW, to Japan and arranged his meeting with Japanese high-ranking officers. In addition, Mr. Ishikawa, Chairman of All Toyota Labor Union, said that Toyota Motor Company should consider making direct investment in the U.S. because there were more than 200,000 unemployed in that industry there. However, he also said that Toyota should neither lower Japan's standard of living nor reduce Japan's employment level in the process.

The Japanese view American labor as less efficient and productive than Japanese labor. Whether this is correct is not relevant; what is relevant is that this is the perception that seems to be held by many senior Japanese business leaders. And since these leaders will be making the decision on whether to invest in the United States or not, their perceptions are extremely important.

It is the conventional view among many Japanese business leaders that American labor is not willing to work as hard as Japanese labor; that the American worker is far less loyal to the company than his or her counterpart in Japan; and that there are far more union-imposed constraints on altering the working conditions in the United States. It is also widely recognized that American labor is not nearly as culturally and racially homogenous as in Japan. Problems in dealing with the demands of minority workers, the concerns of American women for equal treatment and equal pay, and the overall more direct confrontation style of American labor loom heavy in the minds of Japanese managers.

Furthermore, the Japanese feel that they enjoy a distinct market advantage in the fact that their products are made in Japanese plants by Japanese workers. The Japanese manufacturer, whether in automobiles or cameras, takes a great deal of pride in the quality of their products. And a lot of this quality has to do with the quality of Japanese labor. They will frequently point out their experience in building automobiles in Australia. They maintain that they have had great difficulty selling automobiles made by Australian workers in the Australian market. The Australian consumer seems to prefer an automobile made by Japanese workers and exported to Australia.

Why won't the American consumer feel the same way is a question often posed. In their advertising in the United States, for instance, the Japanese manufacturer will go to great lengths to tell the American consumer that this product was made by Japanese labor. "Made in Japan" is thought to be a very important part of the overall ability of the Japanese to expand their worldwide markets, and they are not willing to give up this competitive advantage idly.

The outcome of these social and economic constraints will not be to seriously curtail direct investment by the Japanese in the United States. Rather it is likely to make them very cautious about where and how they invest. They will clearly attempt to avoid the centers of strongly unionized labor. This means that most of their investment will probably occur in the southern states and the west. There are, of course, other reasons than labor for such a location. The climate is milder, reducing energy costs. These states represent the growth areas of the nation, and the Japanese want to locate in the growing markets. And the southern states offer lower taxes, less government regulation, and lower costs of living than do most of the northern states.

The types of industrial activity that are located in this country will also be affected by these constraints. There will be a reluctance to locate automobile and steel manufacturing plants in the United States, for instance, because of the perceived lower quality of labor and the existence of strong unions in those industries. Automobile plants will be located here, not because of economics, but out of fear of rising protectionism. The Japanese are far more likely to move some of their other capital goods industries, particularly those that are energy intensive, along with consumer goods industries to this country.

VII. The Threat of Protectionism in the United States

The discussion so far has concentrated on the likely policy actions to be taken by the Japanese regarding direct foreign investment. We have seen that Japanese investors will respond to powerful economic and political forces, they will be guided in their actions by the official policies of the Japanese government, and they will take into consideration certain social and economic constraints. Yet there is a final area of consideration that will greatly affect their investment plans which is outside of their control, and that is the possible development of a protectionist policy in the United States.

There are clearly increasing signs of protectionist attitudes in the United States. The most visible of these, of course, is the automobile issue as we noted earlier. Yet the feeling among many Americans that we are being "invaded" by foreign imports and foreign investors has been evident for some time. We only have to note some of the news headlines in recent years to see this trend. Newspaper articles have appeared with great regularity reporting on "alien" foreign investors whose investments are an "invasion." They are "mysterious big spenders" who "gobble up" American farmland and "launch" investment corporations.[8]

In a recent New York Times-CBS news poll, it was reported that seven out of ten Americans favored the protection of workers' jobs from import competition even at the cost of higher prices for some products. In a Roper Organization poll in 1977 six out of ten Americans thought that the government should place restrictions on imports of goods priced lower than comparable American products.

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[8] These quotes are from the following articles: "Farm Buys By Aliens Raise Fears," State Government News, April 1979, p. 3; "The Foreign Investment Invasion," National Journal, April 29, 1978, p. 1; "A Hard Look/Mysterious Big Spenders: Aliens Buying Our Farms," San Francisco Examiner, September 8, 1978, p. 1; "Invasion of the American Heartland: A Report on How and Why Foreign Investors are Gobbling Up Choice U.S. Farms, Saturday Review, October 15, 1977, p. 19; and "Iranian Launches AEMBAF Investment Corporation in Turlock," Modesto Bee, October 23, 1977.

[9] In June, 1980, the New York Times-CBS news poll interviewed 1,517 Americans, asking the question: "Which do you think is more important--to protect workers' jobs at the cost of higher prices for some products, or to be able to buy foreign goods at lower prices at the cost of some unemployment in this country?" This question clearly posed the issue in the correct terms of the essential trade-off between import restrictions and inflation. The only other similar poll was made by the Roper Organization in 1977 with results essentially the same as in the New York Times-CBS poll. Quoted in: "Poll Finds Protectionist Trend," New York Times, June 27, 1980.

The public statements by union and corporate leaders in the automobile industry, the news headlines, and the polls all point out the confusing nature of the protectionist trend. On the one hand, the union leaders are arguing that the Japanese should be required to locate some of their production facilities in the United States to provide jobs for American workers. Automobile executives, on the other hand, want limits placed on the importation of Japanese cars, along with government relaxation of environmental regulations and tax relief. Yet many of the "scare" stories in the newspapers are reacting to foreign direct investment that is already being made, while the polls indicate that it is "cheap" foreign imports that are the problem.

Imports and foreign investment are so intertwined in the discussion that the real issues have become rather confused. Do we want to encourage direct foreign investment or not? Are we going to treat direct foreign investment as a trade-off for imports into this country? Are there certain industries where direct foreign investment is welcome, and others where it is not? Will we welcome investors from some countries moreso than from others?

The main cause of this confusion is the lack of a clear policy regarding imports and direct foreign investment in the United States, as compared to Japan where the policy is fairly explicit. The United States has long followed an official public policy of laissez faire regarding both direct foreign investment in this country and investments made by U.S. firms abroad. There is little effort at the national government level to either encourage or discourage such investment.[10] The U.S. government makes no concessions to foreign firms wanting to invest in this country, it offers little assistance, nor does it even collect very good data on how much investment is actually made by foreign firms in the U.S.

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[10] Contrary to the national government, state governments have long been active in the foreign investment arena. Numerous delegations of state dignitaries, frequently led by the governor of the state, have paid visits to foreign countries to attract foreign investment. Also state governments are becoming increasingly involved in trying to develop an appropriate public policy to deal with foreign investments that may not be so welcome, such as the purchase of farm land. The laissez faire position of the national government and the aggressive activities of the state governments only adds to the confusion regarding our overall position.

Such a public policy does not come from a lack of concern to the issue. Rather it flows from a very basic economic philosophy that the operation of the free market will most efficiently allocate resources, and that government intervention will only lead to economic inefficiency. If economic considerations, such as relative labor and energy costs, the availability of market opportunities, and the cost of capital, indicate that it would be more efficient to locate a production facility in the United States rather than continue exporting to our markets, then the foreign firm should be allowed to build their facilities in this country.

So pervasive is this basic economic philosophy that the United States government has a difficult time in deciding when and how to intervene when direct foreign investments might conflict with other national policy goals. Should foreigners be allowed to buy our prime agriculture land? Should we protect certain industries that are essential to our national defense? Do these industries include U.S. Steel Corporation? General Motors Corporation? IBM? When should government intervene to protect the jobs of American workers? Yet if jobs are protected what is the appropriate trade-off with the interests of consumers? Inflation?

Part of the reason for this laissez faire policy is that direct foreign investment has traditionally been quite small and obscure. The Dutch, the British, and the Canadians have long invested in the United States, but few Americans knew what and how much was owned by these foreigners. And indeed, we did not really view them as foreigners, especially since we were investing far more in their countries than they were in ours. As long as they did not object to our investments, we did not concern ourselves with theirs.

Furthermore, the days of protection of infant industry were long past. During the post-war growth era, the time from the end of the Second World War to the early 1970s, American industry was far from infant. We dominated the world economy. There was little to fear from foreign competition. Our enormous economic strength, our superior technology, our massive ability to grow isolated us from the vulnerability to foreign competition that was so prevalent between the economies of Western Europe.

When foreign competition did threaten domestic industries, such as the well publicized invasion of our textile industry by far cheaper products made in Japan and other Asian countries, the problem was viewed as one of dislocation. It was natural in the normal evolution of a mature economy that less skilled labor intenstive industries should be displaced. The workers in those industries could readily be absorbed in higher technology industries, such as electronics. And since our economy was growing so rapidly during this post-war era, the relocation of displaced workers was not an overwhelming problem.

This indifference came to a sudden end when the OPEC countries quadrupled the price of oil in 1973. This price increase transferred billions of dollars of wealth from the industrialized world to the oil rich middle eastern nations. These nations, in turn, began to invest quite heavily in the United States. While nearly all of the investment was in the form of short term bank deposits and the purchase of U.S. Treasury certificates, there was some investment in American real estate and the purchase of several small banks. These were truly "foreigners" who were now investing in the United States, and the American public became alarmed, generating the newspaper articles with their "scare" headlines.

Even more important, however, was what was happening to the basic strength of the American economy. After years of neglect in investing in new and modern productive capacity, we suddenly found ourselves less able to compete in both our domestic and foreign markets. The growth rate of our productivity had fallen significantly behind that in all other industrialized nations--with the sole exception of the United Kingdom--and so inflation became a more serious problem here than abroad. Key industrial sectors began to lose their markets to foreign competition, particularly steel and automobiles. And we found outselves living in a world in which the ability to export was increasingly essential to pay for the costs of imported oil, and we lacked the ability to compete with such strong export oriented nations as Japan and West Germany. All of these "basic structural problems" were exacerbated by a recession and a presidential election. Consequently, it is difficult to know whether the protectionist sentiment that is becoming increasingly visible in the United States is a basic change in attitudes, with portends that we will indeed adopt a strong protectionist public policy in the future, or simply a short-term phenomena that reflects a host of cyclical and structural vicissitudes, and our traditional policy of laissez-faire and free trade investment will remain intact.

If the United States were to shift from a free trade-investment to a protectionist policy, the implications for Japanese investment in this country would be significant. One of the ironies of such a change in American policy is that such investment would probably increase. A protectionist policy would undoubtedly be heavily weighed towards protecting certain key American markets from the intrusion of foreign imports through marketing agreements and import quotas. Therefore the Japanese would be forced to place their production facilities in this country if they want to maintain their markets. Rather than producing television sets, computers, and automobiles in Japan and exporting to the United States, these products would be produced and sold in the United States.

Yet the Japanese would not be coming to the United States as "free and willing investors." They would be reacting to direct threats to their economic security, responding to the "club" rather than to a "carrot." It is certainly not the type of policy that would engender a feeling of mutual trust and cooperation, nor would it enhance the economic alliance between the United States and Japan that has been carefully nurtured and matured over the years. And if the United States were to adopt a far broader protectionist policy, imposing controls on direct foreign investment in order to protect such temporarily weak American industries as steel and automobiles from the competition of domestically produced products, the economic alliance between the two nations might well be permanently ruptured.

VIII. Conclusion

While there are a great many uncertainties regarding the particular policies that will be adopted by the Japanese government as they implement the recent amendments to their Foreign Exchange and Foreign Trade Control Law, and the American government as it reacts to the protectionist sentiment that is appearing in this country, there are certain recommendations that the "Wisemen" could make:

First, the United States government should be clearly warned that a shift to a protectionist policy in this country would do irrevocable damage to the economic alliance that has grown between Japan and the United States. It would place severe strains not only on our economic relationships, but also on our political and military alliances.

Second, the most important action that the United States can take to encourage Japanese direct investment in this country is for the strength of the U.S. economy to be materially improved. Many of the points of conflict between the two nations arise out of weaknesses in certain key American industries. A strong steel, automobile, or electronics industry in the United States would have little to fear from Japanese competition. Yet when these basic industries are weak protectionist pressures arise. A strong U.S. economy is in the best interests of both nations.

Third, the most effective way to strengthen the U.S. economy and certain key industrial sectors is through a rapid increase in investment in basic and applied research and more modern and efficient plant and equipment. Tax incentives, such as the investment tax credit and rapid depreciation, and increased government spending on research are well established means for achieving these results. The American administration should be encouraged to increase these tax incentives and government expenditures.

Fourth, there may be a need to provide special incentives to specific industries, such as proposed in some of the discussions of an "industrial plan" for American industry. Yet the administration should be cautioned that there is an inherent danger that the re-industrialization of America could well take the form of protection of basically weak industries. To impose constraints on Japanese imports of automobiles, for instance, as a policy to "re-industrialize Detroit is no more than protectionism. It would be far better to provide the automobile industry, along with all other industries, incentives to strengthen their competitive capability rather than to protect their weaknesses.

Fifth, the national government must begin seriously to develop an overall policy regarding foreign trade and investment. Many of the elements of such a policy now exist. We have experimented with Domestic International Sales Corporations which provided income tax advantages to U.S. manufacturers who sell abroad. The Overseas Private Investment Corporation, OPIC, provides protection against certain losses for American firms who invest in "friendly developing countries." The Departments of State and Commerce cooperate in setting up Trade Centers in major world markets, and in conducting trade fairs. Senator Adlai Stevenson has introduced the "Export Trading Company Act of 1980" which would provide tax incentives to American firms to establish trading companies similar to those operated by the Japanese.

Yet all of these activities do not constitute an effective national policy. They are ad hoc efforts to solve a far more basic problem. An overall policy must address such basic issues as: (a) What is the appropriate trade-off between protection of jobs and inflation? (b) Should foreign investors be permitted to invest in any U.S. industry, or are certain industries "off-limits?" What are the industries that are off-limits and why? (c) How will the United States respond to foreign investors who receive subsidized loans from their government or banks, or receive other forms of subsidization that are standard procedures in the foreign country but not in the United States? Until some of these basic issues are answered it is impossible to develop an effective policy regarding trade and investment.

Sixth, it is important that American business leaders and government officials recognize that there will be a difficult adjustment period as the Japanese government and Japanese private industry go through necessary fine tuning to adopt to the new era of liberalization of the Foreign Exchange and Foreign Trade Control Law. We must be sensitive to the manner in which these issues are worked out in Japan, and not become too beligerent in our demands for faster progress.

Seventh, it is important that Japanese business leaders and government officials recognize that the United States faces a difficult adjustment period as we learn how to become export oriented, make the necessary structural changes to strengthen our economy, and develop an effective national policy regarding foreign trade and investments.

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